A BUSINESS RESCUE MODEL FOR UNINCORPORATED BUSINESS ENTITIES IN SOUTH AFRICA

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DECLARATION

I Kudzai Mpofu, declare that the thesis that I herewith submit for the doctoral degree, Doctor of Laws, at the University of the Free State, is my independent work, and that I have not previously submitted it for a qualification at another institution of higher education.

I also declare that no work of other scholars has been used without the means of proper citation and that all sources I have used or quoted have been indicated and acknowledged by means of complete reference.

…… **21-10-2022**

Signature **Date**

DEDICATION

To my brothers, Rodwell and Mike Mpofu.

Trust in the Lord with all your heart, and do not lean on your own understanding [or knowledge]. In all your ways acknowledge Him, and He will make straight your paths. Proverbs 3:5-6.

ACKNOWLEDGEMENTS

I give glory to our Lord and Saviour for his sustenance during the course of my study. It is because of His providence that this work was accomplished.

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EDITOR

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Yours sincerely

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ABSTRACT

The significance of small and medium enterprises in promoting economic growth has received sufficient academic and legislative attention. However, little attention has been paid towards promoting and promulgating legislation that oversees the recovery of small enterprises in financial distress. The study compares business rescue schemes applicable to sole proprietorships and partnerships to draw lessons for the legislature and policymakers in South Africa. The current legislation on business rescue and debt review intentionally exclude sole proprietorships and partnerships mainly because of their legal personality. The *Companies Act* of 2008 only admits incorporated companies to business rescue. Furthermore, the *National Credit Act* 2005 excludes partnerships from debt review because the legislature classified them as juristic persons. For this reason, sole proprietorships and partnerships in financial distress cannot depend on the current legislation to facilitate restructuring proceedings.

Therefore, the study identifies the key elements of an effective business rescue scheme which may apply to unincorporated business entities. Through a comparative assessment of different rescue regimes, it was concluded that an efficient rescue scheme must consist of an eligibility criterion, a procedural framework consisting of a step-by-step rescue process and an institutional framework with already pre-determined role players. The main conclusions from the study are that the eligibility criterion must only admit business debtors to the business rescue process. On that note, it was observed that it would be necessary to regulate the liability of sole proprietorships and partnerships during the rescue process. This may be achieved by recognising them (sole proprietorships and partnerships) as legal persons for purposes of business rescue.

The study shows that the step-by-step procedure should include a commencement procedure that allows owners of sole proprietorships and partners in a partnership to apply for business rescue. As soon as the procedure commences, a moratorium on creditors' rights must be automatically activated. The stay should protect the business, the owners, and the codebtors. While the moratorium is the operation, the business

rescue practitioner must prepare a business rescue plan that includes the treatment of secured and unsecured creditors. More so, consideration must be made on the possibility of selling parts of the business, merging the business with other successful businesses or incorporating the business. The study revealed that it may be necessary for the legislature to allow the debtor to continue borrowing during the business rescue process. However, the rescue process is terminated if the business rescue plan is fully implemented or the debtor faces unforeseen economic hardships. The effect of termination is that the debtor is discharged.

The study indicates that the institutional structure should include the debtor, the business rescue practitioner and a specialised judge. The success of business rescue depends on the honesty and cooperation of the debtor. It was concluded that to reduce the cost of business, rescue the debtor may remain in control of its business but must be monitored regularly by appointing a state-sponsored business rescue practitioner who reports to the creditors. In the event that the creditors have reason to mistrust the debtor's honesty, they may choose to appoint and pay for a private business rescue practitioner jointly. In that case, the debtor must cooperate with the business rescue practitioner who oversees or monitors the rescue process. The business rescue practitioner must regularly report to the creditors and the court about the success or failures of the debtor. Since business rescue involves different areas of study, including business, law and financing, it was concluded that South Africa might need a specialised court system. Establishing an administrative institution akin to the Office of the official receiver would also be necessary to oversee the rescue process. Such an institution may be subsidised by the state to reduce the cost of business rescue. Generally, most of the observations made during the study were included in the recommendation to the legislature.

Keywords: business rescue process, financial distress, business debtors, unincorporated business entities, moratorium, post-commencement finance, discharge, rehabilitation, business rescue practitioner, specialised judges.

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LIST OF ABBREVIATIONS AND ACRONYMS

BRP	Business rescue practitioner
CA	Companies Act
CPA	Consumer Protection Act
DRO	Debt relief order
DTIC	Department of Trade, Industry and Competition
EA	Enterprise Act
GN	General Notice
GNP	Gauteng North High Court, Pretoria
GSJ	South Gauteng High Court, Johannesburg
IA	Insolvency Act
IP	Insolvency practitioners
INSOL	International Association of Restructuring, Insolvency & Bankruptcy Professionals
IPO	Insolvent Partnerships Order
IVA	Individual voluntary arrangement
LPA	Limited Partnership Act
LLP	Limited liability partnership
LLPA	Limited Liability Partnership Act
NSBA	National Small Business Act
NCA	National Credit Act
PA	Partnership Act
PVA	Partnership voluntary arrangement
SA	South Africa
SCA	Supreme Court of Appeal
SEDA	Small Enterprises Development Agency
SMMEs	Small micro and medium enterprises
UBEs	Unincorporated business entities
UK	United Kingdom
UNCITRAL	United Nations Commission on International Trade Law
US	United States
WCC	Western Cape High Court

Chapter 1
BACKGROUND

1.1 INTRODUCTION

In a growing economy, small businesses such as sole proprietorships and partnerships account for a significant share of the informal sector.[1] These businesses are recognised as essential contributors to economic growth.[2] Thlegair impact on the economy is visible in job creation, income distribution, increased trade and poverty alleviation.[3] In South Africa, it has been estimated that small businesses account for between 57 and 68 per cent of the country's gross domestic product in the third quarter of 2019.[4] Before the COVID-19 pandemic, the sector employed around 10 million people, accounting for approximately 66 per cent of all employment in the country.[5]

Statistics South Africa indicates that an average of 2 500 individuals and partnerships were sequestrated in 2018.[6] This number has risen to 3 000 in 2019 and decreased to 1 800 in 2020.[7] However, it is predicted that 42 per cent of small businesses will close their doors by 2022.[8] The failure of profitable businesses results in job losses,[9] unpaid debts, decreased economic development, and reduced service delivery to the

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1 See Mtshali & Chinyamurinda 2021: 2; Maziriri & Chivandi 2020: 1-5.

2 Mafini & Okoumba 2018: 1-2; see also Abor & Quartey 2010:219-277; Luiz 2002:58-68.

3 Sunjka & Emwanu 2015:1469-1486; see also Baumann *et al* 2013:693-705; Kraus *et al* 2012:161.

4 Small Enterprises Development Agency (SEDA), Annual Report 2019:1. SEDA is a division of the South African Department of Small Business Development. It is responsible for implementing the government's small business strategy, developing and implementing a standardised and common national delivery network for small business development, and integrating government-funded small business support organisations at all levels of government. This work relied on the reports provided by SEDA and accepted these reports as accurate.

5 *South Africa Economic Outlook* 2020:4. See also Gumede 2000:5.

6 Statistics South Africa 2021:8. Statistics South Africa is South Africa's national statistical agency. Its mission is to produce timely, reliable, and official statistics in order to foster economic growth, development, and democracy. The statistics provided in this work are taken from Statistics South Africa and deemed to be a true reflection of the current situation in South Africa.

7 Statistics South Africa 2021:8. Individual in this case refers to natural persons whether or not involved in business as an entrepreneur.

8 SA Department of Small Business 2021:1. According to a survey conducted by 22 On Sloane, up to 55 000 small businesses are expected to fail during COVID-19, with at least 42 350 individuals expected to lose their employment.

9 South Africa Economic Outlook 2020:3. The first quarter review shows that the employers in the SMME sector retrenched a number of employees, leading to a decline in SMME employment. This is likely to worsen during the ensuing period.

community.[10] The legislature promulgated three Acts to regulate the affairs of a debtor in order to avoid sequestration or liquidation of the debtor's estate, namely the *Insolvency Act* of 1936 (IA 1936),[11] *Companies Act* of 2008 (CA 2008) [12] and *National Credit Act* of 2005 (NCA 2005).[13] These Acts provide some form of debt-restructuring schemes aimed at rehabilitating the debtor and, where possible, avoiding liquidation. The main advantage of debt restructuring schemes is that if the debtor remains economically active, its creditors stand a chance to receive a better return.[14] However, it seems that these legislation fail to facilitate business rescue for sole traders and partnerships.[15]

The IA 1936 provides for the sequestration of the estates of natural persons and partnerships and includes provisions with traces of debt restructuring.[16] The Act has incorporated provisions on compositions. A composition is an agreement between a debtor and its creditors wherein the parties agree that the debtor settles the creditors' claims by paying less than 100 cents in a rand, or obtains a suspension of the debt payment.[17] The composition affords the debtor a partial discharge of the debts or moratorium if approved by the majority of creditors.[18] This gives the debtor room to restructure its debts to resuscitate its business.

A debtor's estate can be saved from sequestration by using either a common law or a statutory composition.[19] The common law composition is contractual in nature and only binds creditors who have consented to it.[20] This may result in creditors obtaining

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10 According to Cassim *et al* 2012:863, "[t]he economy as a whole suffers when a company is shut down. But if a company is successfully rescued or turned around, creditors will receive payment, jobs will not be lost and the company will be able to pay its taxes."

11 *Insolvency Act* 24/1936:sec. 119(1)-(7).

12 *Companies Act* 71/2008: Chapter 6.

13 *National Credit Act* 34/2005, as amended by the *National Credit Act* 7/2019.

14 *DH Brothers Industries (Pty) Ltd v Gribnitz NO & others* 2014 (1) SA 103 (KZP): par. 27. Gorven J stated: "Business rescue proceedings are geared at providing a window of opportunity to restore an ailing company to financial health and functionality." This view was later confirmed by the Supreme Court of Appeals in *Louis Pasteur Holdings (Pty) Ltd and others v ABSA Bank Ltd and other* 2019 (3) SA 97 (SCA): par. 26.

15 Sole proprietorships and partnerships are also known as unincorporated business entities (UBEs) because they are not registered in terms of the Companies Act 2008 or any other legislation.

16 *Insolvency Act* 1936: sec. 119(1). That section states that at any time after the first meeting of the creditors of an insolvent estate, the insolvent may submit to the trustee of his estate a written offer of composition.

17 Bertelsmann ***et al*** 2008:546; Roestoff & Coetzee 2012: 70-71.

18 Bertelsmann ***et al*** 2008:546; Roestoff & Coetzee 2012: 70-71.

19 Boraine ***et al*** 2012:254; Mabe 2019:9; Kelly-Louw 2008:222.

20 *De Wit v Boathavens CC (King intervening* 1989 (1) SA 606 (C): 611; see also *Mahomed v Lockhat Brothers & Co Ltd* 1944 AD 230: 240-241. Bertelsmann ***et al*** 2008:546-547 provided that "[a]n insolvent whose estate is subject to provisional sequestration may enter into an agreement with some or all creditors and the

a larger payout than they would under sequestration while the debtor gets discharged.[21] The downside of the common law composition is that the majority's decision cannot bind the dissenting minority.[22] Thus, a common law composition can only be effective against creditors who agree to it.[23]

The statutory composition is provided in terms of section 119 of the IA 1936. At any time following the first meeting of creditors, the debtor may submit a written offer of composition to the trustee.[24] Creditors must approve and accept the agreement if their votes total at least three-fourths in value and three-fourths in the number of all creditors who have proven their claims against the estate.[25] This implies that the compromise does not have to be approved by all creditors to be binding on them.[26] Nevertheless, a statutory compromise does not guarantee the rehabilitation of the debtor.[27] In other words, even if a debtor obtains a majority vote in favour of the composition, not all obligations can be discharged. A debtor in this situation can only apply for rehabilitation after receiving a certificate from the Master of the High Court after accepting a composition discharging all its debts.[28] It appears that the terms of compositions are too stringent to facilitate debt reorganisation for unincorporated business entities (UBEs).[29] Besides, it is not the primary objective of the IA 1936 to guarantee debt relief. In *R v Meer*[30] the court held that "the *Insolvency Act* of 1936 was

provisional trustee, if any, agreeing to pay specific dividends on creditors' claims, subject to the provisional order of sequestration being discharged".

21 *Paruk v Parker, Wood Co Ltd* 1917 AD 163*; Zulman v Schultz* 1924 TPD 24; *In re Estate Wilson* 1936 NLR 566.

22 *Prinsloo v Van Zyl* 1967 (1) 581 (T):583. The court stated that the agreement is only binding if all concurrent creditors consent, because dissenting creditors are free to apply for sequestration of the debtor's estate and thereby nullify the arrangement's effect.

23 *De Wit v Boathavens CC King intervening* 1989 (1) SA 606 (C):611. In *Harrington v Fester* 1980 (4) SA 424 (C), it was noted that if the offer of composition includes what could be construed as a sale of assets by the provisional trustee, the purported sale requires approval by the Master.

24 *Insolvency Act* 1936:sec. 119(1).

25 *Insolvency Act* 1936:sec. 119(7).

26 *Blou v Lapert and Chipkin NNO* 1970 (2) SA 185 (T):206; *Ingel and Taubkin's Trustee v The Master* 1925 OPD: 86.

27 Roestoff 2000:131; Roestoff & Coetzee 2012: 71 states that "the main deficiency of this proposed measure[compositions] as a viable option for a debtor seeking debt relief is that it would not, in its current format, provide such a debtor with a discharge if the composition is not accepted by the required majority of creditors."

28 *Insolvency Act* 1936 sec. 119(7); *Ex parte Mohamend* 1923 TPD 19.

29 Bertelsmann *et al* 2008:546; Sharrock 2012:205. However, in *Ingel and Taubkin's Trustee v The Master* 1925 OPD:86, the court stated that unless a particular term in the offer of composition is a condition of the acceptance of the offer, its non-fulfilment by the solvent is not a ground for treating the composition as a nullity.

30 *R v Meer* 1957 (3) SA 614 N 619.

passed for the benefit of creditors and not for the relief of harassed debtors".[31] For these reasons, UBEs cannot be effectively restructured in terms of the IA 1936 in its current form.

Insolvency legislation has been under review for years.[32] The South African Legislation Reform Commission initiated an extensive review of the insolvency law in 1987, which resulted in the Draft Insolvency Bill of 1996.[33] The bill's first draft failed to address critical concerns such as unifying insolvency procedures for individuals and legal persons.[34] The second Insolvency Bill was published in 2000, and this draft was meant to replace the IA 936. Despite the fact that the Draft Insolvency Bill 2000 was intended for individuals, it included provisions for juristic persons by using terms that could be used to refer to both natural and corporate persons.[35]

However, three years later, the cabinet authorised the consolidation of the insolvency legislation. The Draft Insolvency and Business Recovery Bill featured aspects of both personal and corporate insolvency.[36] However, while waiting for the finalisation of the Bill, companies were being liquidated at an alarming rate. As a result, a business rescue procedure for companies became an urgent necessity. The Department of Trade, Industry and Competition (DTIC), which regulates companies and close

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31 *Fesi v ABSA Bank Ltd* 2000 1 SA 499 (C). In *Zulman & Others v Schultz* 1924 TPD 24, the court held that "where creditors accept an offer of compromise, not in the honest belief that the compromise is in the interests of the estate or for the benefit of creditors generally, but from feelings of pity or benevolence towards the insolvent, or with a view to benefiting him or form some collateral object, the acceptance is invalid". Smith 1985: 27. *P Southern Africa (Pty) Ltd v Furstenburg* 1966 (1) SA 717 (O) at 720, Erasmus J remarked: '[T]he whole tenor of theAct, inasmuch as it directly relates to sequestration proceedings, is aimed atobtaining a pecuniary benefit for creditors. Smith points out in this article that the term "advantage of creditors" appears in numerous sections of the Act. She investigates these sections as well as those that are clearly designed to benefit creditors, despite the fact that the term is not used (eg ss 13(1), 19, 21, 23,26, 29, 30, 65, 119 and 152).

32 South African law reform committee members worked on Preference in Insolvency Project 37, Working Paper 1, and its subsequent Report on the Review of Preferent Claims in Insolvency Project 37 Interim Report, published in 1984, before forming the South African Law Reform Committee in 1987.

33 The 1996 Draft and its Explanatory Memorandum were published in 1996 as the Review of Law of Insolvency: Draft Insolvency Bill and Explanatory Memorandum Working paper 66 Project 63, 1996.

34 Boraine & Van der Linde 1998:621-63.

35 The Explanatory Memorandum to the Draft Insolvency Bill 2000 stated the following: "There is strong support for uniform provisions for all corporate and individual insolvencies, at least as regards the administration of the liquidation process, with nuances for banks, insurance companies and others where such differences are justified by structural requirements. The Bill is drafted in such a way that it would not be too difficult to adapt the provisions in question for legal persons. Uniform provisions for individuals and companies and substantive corporate law issues like rescue procedures are under consideration by the Standing Advisory Committee on Company Law."

36 The Draft Insolvency and Business Recovery Bill 1999 was prepared for the Standing Advisory Committee on Company Law and the Insolvency Project Committee of the South African Law Reform Commission by the Centre for Advanced Corporate and Insolvency Law at the University of Pretoria; hence, the conclusions and recommendations in the Bill were not final. However, they provided proposals for reform.

corporations, published a policy document outlining its review of company law that was intended to form part of a new CA 2008.[37] More importantly, the policy included insolvency and corporate rescue as one of the six main themes of the new CA 2008. The other themes included company formation, the company's memorandum of incorporation, mergers and acquisition and business rescue.[38] Furthermore, it was considered that provisions regarding corporate insolvency (corporate rescue or liquidation) should be retained in company law.[39] This meant that the new CA 2008 would only apply to companies and close corporations.

With the Draft Insolvency and Business Recovery Bill under consideration, the parliament approved CA 2008. On 9 April 2009, the president assented to the new CA 2008. Since then, progress on the Draft Insolvency and Business Recovery Bill has been at a standstill. The passing of CA 2008 made it clear that the idea of business rescue for sole proprietorships and partnerships remained a dream in the pipeline.

The CA 2008 introduced the business rescue regime regulated in terms of Chapter 6. Business rescue allows the company to restructure its business by imposing a moratorium on legal proceedings.[40] This procedure is often the last resort to avoid liquidation. Since the inception of business rescue in 2008, 3 298 companies have filed for business rescue, with 531 successfully implementing business rescue plans.[41] However, business rescue is only applicable to companies in financial distress and this excludes sole proprietors and partnerships because they are not regarded as juristic persons. Besides, since the debts of the UBE are the debts of the natural person, if UBEs were to be considered for business rescue, it would be difficult to gain the cooperation of unsecured creditors.[42] Most UBEs have single profitable assets;

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37 The Department of Trade, Industry and Competition (also known as the DTIC) is the South African government department responsible for commercial and industrial policy. The DTIC and its subsidiary agencies are responsible for economic development, black economic empowerment, enforcing commercial law (including corporate and intellectual property law), promoting and regulating international trade, and protecting the ordinary consumers.

38 GK 1183 Government Gazette 2004:19-41.

39 GK 1183 Government Gazette 2004:9. The Guidelines for Corporate Reform state: "The reform of South African Company law will involve an overall review of company law, that is the *Companies Act*, 1973, the *Close Corporations Act*, 1984, and the common law relating to these corporate entities. The review will not include partnership law."

40 Companies Act 2008:sec. 28; *Ferrpstall GMBH and another v Transnet SOC Ltd and Others* 2019 (6) SA 490 (WCC).

41 Companies and Intellectual Property Commission report on business rescue 2021:1.

42 European Law Institute 2017:370 par. 764; Levenstein 2016:140; Loubser 2007:441.

hence it would be difficult to secure post-commencement finance, especially where new finances require security or collateral.[43] Furthermore, the tariff fees for business rescue practitioners (BRPs) are pegged at R1 250 per hour, to a maximum of R15 625 per day (inclusive of VAT) in the case of a small company.[44] This renders the procedure cost-ineffective for undercapitalised UBEs. [45]

The NCA 2005 is one legislation aimed at addressing and preventing consumer overindebtedness by providing mechanisms for debt restructuring in Chapter 4.[46] However, Chapter 4 of NCA 2005 expressly excludes juristic persons from applying for debt review or debt intervention.[47] NCA 2005 defines a juristic person as including a partnership, association, corporate and unincorporated or a trustee.[48] This technically means that partnerships cannot apply for debt review provided in NCA 2005. It is argued that even if UBEs were allowed to apply for debt review, the procedure is not business-orientated. If debtors are placed under debt review, they are not allowed to incur any further debt.[49] This automatically prohibits the injection of post-commencement capital, which is crucial for the rehabilitation of the business.[50] Second, the procedure does not prohibit non-credit agreement creditors from applying for sequestration.[51] Therefore, the endeavour to rescue UBEs in terms of NCA 2005 has a significant potential to be interrupted by sequestration proceedings.

1.2 RESEARCH PROBLEM

It is clear from the discussion above that there is no business rescue scheme for UBEs in South Africa. Given the unique characteristics of UBEs, including them in Chapter 6 "business rescue model" or in Chapter 4, "debt review scheme" may not be the best solution. The classification of debtors based on their legal form disqualifies UBEs from applying for business rescue.[52] Besides that, the cost of the procedure has the

43 Roestoff & Renke 2005:97; *Snyman v The Master* 2003 1 SA 239 (T).
44 McKay 2019:11; Meskin 2016:666.
45 See Chapter 4 section 4.2.2.3.
46 *National Credit Act* 2005:sec. 3(g).
47 *National Credit Act* 2005:sec. 78(1) stated: "This Part does not apply to a credit agreement in respect of which the consumer is a juristic person."
48 National Credit Act 2005:sec. 1.
49 *National Credit Act* 2005:sec. 88(3).
50 Van Heerden & Boraine 2009:120*; Companies Act* 2008:sec. 135.
51 Sithole 2010:29. *Companies Act* 2008:sec. 1.
52 *Companies Act* 2008:sec. 128.

potential to bankrupt the already distressed businesses. Moreover, the majority of UBEs have insufficient assets to secure post-commencement finance.[53] Consequently, the main objective of the research is formulated as follows:

> To determine the key characteristics and legal practices of a business rescue model that would facilitate the rehabilitation of unincorporated business entities in South Africa

1.3 RESEARCH QUESTIONS

The main research question is formulated as follows:

> What are the key characteristics and legal principles of a business rescue model that would facilitate the rehabilitation of unincorporated business entities in South Africa?

To adequately answer the main research question, the following four questions were addressed:

1) How should debtors be classified to qualify for business rescue purposes?
2) What are the essential features of a business rescue processes that would facilitate the rescue of unincorporated business entities?
3) What are the roles of the debtor, business rescue practitioner, and the judiciary in ensuring that unincorporated business entities are rehabilitated?
4) How can noteworthy international jurisdictions, conventions, and instruments contribute to answering the questions mentioned above?

1.4 MOTIVATION FOR THE STUDY

The research is based on the proposition that a business rescue framework that oversees the rehabilitation of UBEs while considering the interest of all stakeholders would promote business efficacy, and with time, may secure the confidence of local and international investors. Thus, the primary motivation of the study was the preservation of viable enterprises, regardless of their legal form, size or relevant sector. This would, in turn, increase creditor returns, enhance entrepreneurialism and improve the country's competitiveness internationally.

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53 Maphiri 2015:11.

1.4.1 Legal theory

The study assumed that insolvency legislation must weigh the benefits of short-term debt collection through liquidation against the preservation of the debtor's business value through restructuring.[54] Achieving that balance may require consideration of other social policy objectives, such as supporting the development of an entrepreneurial class and employees.[55] The research aimed at preserving the entrepreneurial class by providing a theoretical approach to the business rescue scheme for sole proprietors and partnerships.

The research is based on the communitarian theory.[56] According to this theory, the law of insolvency should consider the interests of the debtor's creditors and the interests of other parties impacted by the debtor's insolvency.[57] These stakeholders include, among others, workers, suppliers, customers, the government, and the local community in which a business operates.[58] There is no comprehensive list of non-stakeholders available. Gross argued that some interests, besides those of the creditors, might be worth considering.[59] He admitted that it is very challenging to quantify interests like public interests, but this fact alone does not justify their removal from an economic theory of insolvency.[60]

However, there is no clear definition of "community" or "public interests". In a similar vein, Keay claimed that it is difficult to agree on the issue of public interest.[61] However, he argued that, for insolvency law, it is appropriate to say that the public interest involves taking into consideration interests for which society has regard and which are wider than those of the parties directly involved in any given insolvency situation.[62] In order for insolvency law to serve society as a whole, communitarianism seems to

54 UNCITRAL 2005:11 par. 6.

55 UNCITRAL 2005: 1 par. 6.

56 See Deakin 2017: 364; Finch 2009:42; Keay 2000: 509-534; Korobkin 1991: 717- 789; Gross 1994: 1031-1048.

57 Finch 2009:40-41; see also Symes 2008:63; Gross 1994: 1031-1032.

58 Deakin 2017: 364; see also Finch 2009: 42; Gross 1994: 1031-1032.

59 Gross 1994 1031-1032.

60 Gross 1994 1031-1032.

61 Keay 2000: 509-534; see also Finch 2002: 28-42;

62 Keay 2000: 509-534; see also Finch 2002: 28-42;

favour both the orderly winding up of businesses where business rescue is not a realistic alternative, as well as the survival of enterprises where it is possible.[63]

Although it is difficult to define the public interest, I believe that the survival of small enterprises owned by historically disadvantaged people is one of the public interests that business rescue legislation in South Africa has overlooked. Many small businesses are operated as sole proprietorships and partnerships, hence excluded from the Chapter 6 business rescue. Therefore, a business rescue model for unincorporated businesses may go a long way towards promoting the black economic empowerment policy in South Africa. Recent studies show that ownership of small businesses active in the formal market is very low.[64] Thus, revisiting the laws surrounding business rescue and debt review is not only important but urgent.

1.4.2 Promote entrepreneurship

A rescue procedure for UBEs has two entrepreneurial benefits. First, a rescue procedure guarantees the debtor a breathing space, thereby releasing the pressure from creditors.[65] This has the effect of upsurging the debtor's willingness to be innovative and even engage in more entrepreneurial activities.[66] Natural persons involved in economic activities are more inclined to pursue business ventures if they are certain that there is a system to cushion their losses.[67] In other words, if potential entrepreneurs know before embarking on a business venture that a rescue procedure mitigates the risk of failing, they are more inclined to push beyond sustenance and

63 Finch 2009:41.

64 SEDA Annual Report 21/22: 34 "Ownership patterns within formal sector enterprises indicated a significant shift, with black people's share of formal sector enterprises declining by more than 25%. Employment data points to significant differences in the effect of the pandemic across enterprises of different sizes. Small businesses employing 50 people and below were disproportionately affected compared to medium businesses employing 50 – 200 people who shed around 20% of total employment. Interestingly, employment in small enterprises remained a quarter below their pre pandemic levels by the end of the first quarter of 2021."

65 Nagel *et al* 2019:448; see also Lee 2011:507: "A country's corporate bankruptcy laws can have an important impact on the level of entrepreneurship in a country."

66 Cirmizi *et al* 2010:5; see also Lee *et al* 2007:257-272: "By limiting downside risks and increasing upside (through business rescue) gains entrepreneurship is encouraged, leading to an increase in and the number and variety of people pursuing entrepreneurial activities."

67 Ayotte 2007:161-185; states that "A forgiving bankruptcy law, in particular one that offers a fresh start from pre-bankruptcy debts, will permit inframarginal entrepreneurs (those who are willing to become entrepreneurs even in the absence of insurance) to re-enter the economy rapidly after a business failure", see also Georgakopoulos 2002:51-95.

maximise their earnings.[68] Furthermore, business rescue would maximise their productive potential, increase their income tax liability and improve their contribution to social security. Smit believes that today's entrepreneur is tomorrow's company.[69]

Second, the incidence of entrepreneurialism is that it maximises national economic activity and also international competitiveness.[70] The number of UBEs filing for sequestration is alarming, adversely impacting the economy.[71] Therefore, developing a business rescue scheme may preserve UBEs as profitable enterprises, which in turn will improve South Africa's competitiveness internationally. Countries compete in foreign marketplaces and through foreign direct investment; hence, a fully involved citizenry is critical to achieving optimum competitiveness with other countries.

1.4.3 Increase creditor returns and investor confidence

A business rescue scheme for UBEs may increase creditor returns and promote investor confidence.[72] On a macro-financial level, effective business rescue schemes enable financial institutions to resolve problem assets more effectively. This can lead to higher volumes of lending with longer maturities, lower costs, and lower collateral requirements.[73] Consequently, investors' perceptions of financial sector stability are strengthened, and the banker's ability to lend is improved. [74]

The World Bank has observed that an effective business rescue scheme can increase predictability, while also increasing lender confidence in loan recovery.[75] Furthermore, increased lending tendencies among financial institutes also lead to financial inclusion for more businesses. Business rescue guarantees a timeous resolution of financial distress by improving transparency and increasing the asset value.[76] An effective business rescue system can also increase the number of people who take on

68 Armour & Cumming 2008:303-350.
69 Smit 1999:12.
70 Burke-Le Roux & Pretorius 2017:1-3; McAlinden & Menk 2013:14.
71 Statistics South Africa 2021: Statistics of liquidations and insolvencies show that an average of 250 sole proprietors and partnerships estates are facing sequestration proceedings each month.
72 World Bank Group 2017a:8.
73 Fan *et al* 2012:23-56; Qian & Strahan 2007:2803.
74 Hotchkiss *et al* 2011:3.
75 World Bank Group 2017a:8.
76 Coetzee & Roestoff 2013:188-210.

entrepreneurial activities by highlighting the downside risk of a venture.[77] This work is motivated by South Africa's need for a rescue regime that accommodates UBEs.

1.4.4 Creation of value for creditors

A business rescue procedure for unincorporated enterprises would address two problems that creditors currently experience. The current legislation dedicated to facilitating debt review for consumer debtors does not give all creditors a fair chance to claim from the debtor.[78] This has resulted in individual creditors blindly pursuing debt relief procedures to the detriment of themselves and other creditors. Therefore, a rescue procedure for UBEs would increase value for the creditors and ensure equal distributions of value in cases where business rescue ends up in liquidation proceedings.

It is argued that maximising the value of assets requires that creditors identify and locate the assets. A debtor is more inclined to disclose the assets if the insolvency systems provide for a rescue regime dedicated to viable enterprises.[79] Pursuing the debtor as an individual creditor is expensive, and it is often in competition with other creditors. [80] In addition, individual debt collection may cultivate deadweight loss if the assets produce no value beyond the cost for legal proceedings. Ordinary enforcement proceedings may have compelling mechanisms for disclosing assets, but a positive incentive would work more efficiently than threats of sequestration. The likelihood of saving the business is a better incentive than compulsory sequestration proceedings. The World Bank recommends that an insolvency system can provide an incentive in the form of discharge where the debtor is forthcoming about the location of his or her assets.[81] Under business rescue, disclosure of assets would increase successful prospects, and the debtor may remain in business.

1.5 RESEARCH METHODOLOGY

The research was purely based on the black letter research methodology. In this regard, the researcher used information available in the library and on the internet.

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77 World Bank Group 2017a:8.

78 See par. 1.

79 World Bank Group 2016:22.

80 Even if a significant value is available on unencumbered assets, individual enforcement actions may reduce the value and increase losses for most of the creditors.

81 World Bank Group 2016:22.

Reference was also made to case law, legislation, e-books, journals, government reports, and international instruments.

A comparative research methodology was adopted to gain a more practical and realistic insight into different business rescue regimes that are implemented in different jurisdictions. These jurisdictions include South Africa, the United States of America (US), the United Kingdom (UK), and the Republic of Kenya. South Africa was chosen for three main reasons. First, the CA 2008 has already implemented a business rescue regime for more than ten years, and its jurisprudence in this area has developed. Second, the proposed business scheme will apply to sole proprietorships and partnerships that operate their businesses in South Africa. The primary sources from South Africa included the CA 2008, focusing on the provisions of Chapter 6 and Chapter 4 of the NCA 2005. Basically, I concentrated on Chapter 6, business rescue, case law, commentaries, and articles to observe the attitude of the courts, legislature and academic writers towards the applicability of business rescue to sole proprietorships and partnerships.

A brief history of bankruptcy law reveals that article 1 of the U.S. Constitution authorises Congress to establish uniform bankruptcy laws throughout the nation.[82] Tabb states that the framers of the United States Constitution had the English bankruptcy system in mind when they included the power to enact "uniforms laws on the subject of bankruptcies."[83] Considering that South Africa was a colony of England, America provides a relevant example to study. The United States was selected as part of the comparison for three main reasons: First, although scholars have already recommended that South Africa should adopt lessons from Chapter 11,[84] it appears there are no extensive studies on provisions that apply to sole proprietorships and partnerships. The research explored the different provisions of Chapter 11 that specifically apply to insolvent partnerships. The reorganisation scheme in Chapter 13 was also examined to determine the treatment of sole proprietorship in financial distress. Second, the *Bankruptcy Code* 1978 has gone under numerous amendments, and courts have had the opportunity to interpret and provide comprehensive

82 Art 1, s8 of the Constitution of United States of America 1787.

83 Tabb "The history of the bankruptcy laws in the United States" 1995 *ABI Law Review* 6;

84 GN 1183 of 2004, *South African Company Law for the 21st Century: Guidelines for corporate law reform*, Government Gazette No. 26493, par. 4.6.2; see also Loubser 2010:9; Smits 1999:80-107.

precedence.[85] I tapped into this wealth of case law, journals, and official reports gaining an insight into the shortcomings and possible solutions of legislation that administrates the rescue of sole proprietorships and partnerships. Third, the US Bankruptcy Court recently acknowledged the South African business rescue model as a legitimate foreign proceeding,[86] and I sought to identify the parallels and variances between these two models.

The UK was of particular relevance to this study because South African insolvency legislation is rooted in English law. [87] It appears that these two jurisdictions have similar legal philosophies and principles regarding sole proprietorships and partnerships.[88] However, England has debt relief schemes for sole proprietorships within its insolvency legislation. Furthermore, the legislation provides relief for insolvent partnerships. These schemes also provided lessons for South Africa. The primary sources were the IA 1986 and the Insolvent Partnerships Order of 1994 (IPO 1994). The latter has been welcomed as an improvement to the IPO of 1986.[89] However, the IPO 1994 has been criticised for being difficult to implement, and some provisions must be read with the IA 1986. Nonetheless, I assessed the relevant provisions to draw lessons that may apply to the South African corporate society.

The inclusion of Kenyan law is based on the fact that it has a mixed legal system that is comparable to that of South Africa. Its legal history is similar to South Africa, and it has already implemented revised insolvency legislation.[90] The IA 2015 contains a wide range of alternatives to bankruptcy that appear to provide debt relief to debtors in financial distress, including sole proprietorships and partnerships. I further analysed recommendations provided by the United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency Law 2005; UNCITRAL Legislative Recommendations on Insolvency of Micro- and Small Enterprises 2021 and rules provided by the European Law Institute on Rescue of Business in Insolvency. Some

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85 The *Bankruptcy Reform Act* of 1978 is a federal law that regulates bankruptcy in the United States. The current *Bankruptcy Code* 1978 was enacted by Section 101 of the Act in 1978, and it came into effect on October 1, 1979. The current *Code* has completely replaced the 1898 *Bankruptcy Act*, also known as the *"Nelson Act".*

86 *In re Comair Limited (in Business rescue)* Case no 21-10298 (JLG), 13 April 2021. In that case, the Bankruptcy Court in New York ruled that the South African business rescue proceedings was recognised as "foreign main proceedings" and granted an automatic moratorium on all claims against Comair in the USA.

87 Belcher 1997:3-27; Calitz 2008:354; Finch 2002:8-20; Fletcher 2009:6; Hunter 1999:491.

88 Burdette 2004a:241-263; Calitz 2008:354; Herbert 1995:303-352.

89 Kavanagh 1995:92-93 ; Otter 1995:2-4.

90 Ayieko 2010:1; Njihia 2015:3; Too 2016:2-8.

of the conclusions and recommendations were derived from the guidelines provided by the International Association of Restructuring, Insolvency & Bankruptcy Professionals (INSOL International), and the Global Entrepreneur Monitor between the period 2018 and 2019.

1.6 CHAPTER OVERVIEW

Chapter 1: Background

The first chapter explains the background of the study. The chapter provides statistics on the number of partnerships and self-employed individuals are discussed to clearly indicate the need for the research. The aim of the research is outlined, and the review of existing literature exposes the gaps in the current legal framework.

Chapter 2: Classification of debtors

Through a comparative analysis, this chapter explores the different business rescue regimes implied in the United States, the UK and Kenya with emphasis on the classification of debtors for business rescue. The observations from the comparative assessment are then used to develop a classification criterion for UBEs. Since partnerships are not recognised as legal persons in South Africa, this chapter puts forward arguments in support of the recognition of partnerships as legal entities for purposes of business rescue.

Chapter 3: Procedural framework

The chapter is dedicated to establishing the most suitable business rescue procedures for UBEs. It compares rescue procedures in the United States, the UK and Kenya, including international best practices. Lessons derived from other countries are employed to create a model procedure for UBEs. The model consists of commencement procedures, the application of a moratorium, the treatment of creditors, the implementation of a business rescue plan and the discharge of the debtor.

Chapter 4: Business rescue participants

This chapter examines the role of the debtor, the BRPs and the court during the business rescue process. The rescue practitioner must oversee the implementation of the rescue plan and also investigate the debtor's affairs. The court is at the centre of the rescue procedure. Its involvement includes protecting the creditors' rights,

enforcing the moratorium and assessing if the debtor's plan is feasible. The government agent is mainly designed to assist the courts in business rescue procedures that can be implemented without the need of the court's assistance. Finally, the chapter proposes how the court should be involved in the rescue of UBEs and suggests ways of minimising the cost of the procedure by involving a government agent-based procedure. [91]

Chapter 5: Conclusion, recommendations and framework

The last chapter embodies recommendations for the legislature and motivation for further studies in this area. Recommendations consist of factors that should be considered for the classification of debtors for business rescue and aspects of the business rescue procedure that should form part of the UBE business rescue model. Furthermore, the conclusion provides ways in which the court can minimise its involvement in the rescue of UBEs.

1.7 KEY CONCEPTS

- **Business rescue moratorium** refers to the stay of legal proceedings or enforcement actions by creditors against the debtors or in respect of its property.
- **Business rescue plan** is a plan developed to rescue the debtor by restructuring its affairs. This may include restructuring the business, its property, debt, other affairs, liabilities, and equity.
- **Business rescue** is a formal procedure aimed at facilitating the rehabilitation of a financially distressed debtor. The debtor is placed under the temporary supervision of a business rescue practitioner who manages the affairs of the debtor. Synonyms of business rescue include *business reorganisation or business restructuring,* or *alternatives to bankruptcy*.
- **Liquidation** brings the debtor's affairs to an end and distributes its assets to creditors and other stakeholders.
- **Rehabilitation or resuscitation** means that the business rescue plan was substantially implemented, and the debtor now operates its business on a solvent basis.

[91] See Chapter 4 section 4.2.2.3

- **Unincorporated business entities (UBEs)** refer to sole traders and partnerships.

Chapter 2
CLASSIFICATION OF DEBTORS

2.1 INTRODUCTION

Almost every insolvency regime has some form of debtor classification system that prescribes whether an individual or business entity qualifies for business rescue. This chapter answers the first research question of this study, namely: *How should debtors be classified to qualify for the business rescue process*?

The chapter is divided into two main parts. The first part provides a comparative analysis of the different criteria that the jurisdictions of South Africa, the United States, the UK and Kenya employ to determine whether UBEs are eligible for business rescue. The comparison is aimed at establishing their attitudes, strategies and policies in addressing the needs of UBEs.

The second part is an in-depth analysis of the different eligibility criteria applicable to UBEs. In this regard, I consider (i) the economic activities of UBEs to determine whether a business and consumer debtors are eligible for business rescue; (ii) creditworthiness as a sifting instrument to distinguish between viable businesses that qualify for business rescue and businesses that require liquidation proceedings; and (iii) commercial morality as a means to prevent fraudulent debtors from becoming beneficiaries of business rescue. More importantly, this part examines the concept of (iv) legal personality, given its capacity to shield the entrepreneur from liability for business debts.

From the onset, it should be noted that it is difficult and almost impossible to determine with certainty how debtors should be classified for purposes of business rescue. On the one hand, a liberal criterion may include part-time entrepreneurs who have no passion or resources for a long-term business. On the other hand, although entrepreneurs are different from ordinary debtors, it is difficult to separate the liabilities of a business from the owner's liabilities.[1] Despite these foreseeable challenges, this question has been addressed with a significant degree of success in many other jurisdictions. The discussion begins with an exploration of the current classification of

[1] UNCITRAL 2005:39 par. 4.5.

debtors in South Africa to identify its successes and failures in assisting unincorporated debtors.

2.2 COMPARATIVE ANALYSIS

2.2.1 South Africa

The history of the South African business rescue regime goes back to the *Companies Act* of 1926, which introduced the concept of judicial management.[2] This notion was later retained in section 427 of the *Companies Act* of 1973 (CA 1973).[3] The main goal of judicial management was to turn around a company in financial trouble due to mismanagement or uncontrollable circumstances.[4] At the heart of judicial management was the desire to preserve viable companies rather than liquidating them.[5]

Nonetheless, judicial management has been viewed by both academics[6] and the judiciary[7] as a failure. Several factors contributed to the failure of judicial management, which included shortcomings in the legislation and the social attitude that prevailed during this era. Rajak and Henning stated that judicial management relied heavily on the courts.[8] It was unavoidable that the cost of the procedure would increase. The court had to issue two orders: provisional and then final order. In this way, even viable businesses found it difficult to seek judicial management due to the high cost of litigation. As Burdette pointed out, the requirement that there must be a reasonable

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2 *Companies Act* 46/1926; see also Henning 1992:91; Levenstein 2015:54; Loubser 2004:138; Mongalo 2010: xviii.

3 *Companies Act* 61/1973:sec. 427 states: "When any company by reason of mismanagement or for any other cause (a) is unable to pay its debts or is probably unable to meet its obligations; and (b) has not become or is prevented from becoming a successful concern, and there is a reasonable probability that, if it is placed under judicial management, it will be enabled to pay its debts or to meet its obligations and become a successful concern, the Court may, if it appears just and equitable, grant a judicial management order in respect of that company."

4 Cilliers & Benade 1982:683; see also Beuthin 1984:241.

5 *Companies Act* 1973:secs. 427-440; In *Lief NO v Western Credil (Africa) (Pty) Ltd* 1966 3 SA 344 (W):345, the court held that "judicial management order provides for a moratorium in respect of the company's debt in the hope that it will lead ultimately to the payment of all creditors; and resuming trading on a solvent basis".

6 Henning 1992:95-96; see also Bowles & Bruyns 2009:13; Burdette 2004b:409-330; Cilliers & Benade 1982:431; Kloppers 1999:426; Levenstein 2010:6-8, 2015:58-64; Loubser 2004:156-157, 2007:152; Olver 1986:87; Rajak & Henning 1999:262. Olver 1986:84 noted that "the success rate of judicial management in avoiding an ultimate liquidation was less than 20 per cent of the limited number of companies who were eligible to make use of the procedure".

7 *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd* [2001] 1 All 223 (C); see also *Tobacco Auctions Ltd v AW Hamilton (Pty) Ltd* 1966 2 SA 500 (R):503; *Rustomjee v Rustonjee Pty Ltd* 1960 (2) SA 101 (D):107.

8 Rajak & Henning 1999:268.

possibility that the debtor will become a successful concern placed an extremely high standard on the applicant's ability to prove its case.[9]

Furthermore, the courts had the discretion to grant a moratorium on legal proceedings. A moratorium order was not automatic. As a result, the debtor company was denied the "breathing space" required for business recovery in cases where it was not granted.[10] More so, the CA 1973 did not provide any monitoring mechanism on the progress of the judicial manager. Hence, the judicial manager was paid despite failing to provide substantial feedback on the company's progress.[11]

The then prevailing social attitude towards companies in financial distress was unfavourable to judicial management.[12] During this era, creditors preferred to relegate a company in financial distress to liquidation proceedings rather than subjecting it to judicial management. The CA 1973 was creditor-orientated.[13] In other words, the CA 1973 emphasised the creditors' rights while undermining the debtors' interests.[14] The Minister acknowledged that companies form the cornerstones of South Africa and its economy.[15] Therefore, judicial management was seen as an attempt to recover companies on the verge of insolvency. However, the legislature failed to reflect this intention in the wording of the Act.[16] The lack of restrictions on the company's size, type, and business meant that any company was eligible for judicial management.[17] For this reason, the courts adopted a restrictive and conservative approach to the interpretation of the CA 1973.[18] As a result, many applications were dismissed for failure to meet the requirements stipulated in section 427 of the CA 1973.[19] To make matters worse, Chapter 1 of the CA 1973 restricted the application of judicial

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9 Burdette 2004a:249.

10 Kloppers 1999:430.

11 Loubser 2004:144.

12 Kloppers 1999:426.

13 Bradstreet 2010:197-198: A creditor-orientated model places the needs of creditors as a priority. It is based on the view that the main objective of the law of insolvency is to maximise the debtor's assets for the creditors.

14 Bradstreet 2010:197-198.

15 Union of South House of Assembly Debates 1926:983-984.

16 Union of South House of Assembly Debates 1926:983-984.

17 Loubser 2007:157.

18 Kloppers 1999:426 stated that "although there is nothing in the legislation that merits the treatment of judicial management as an extraordinary measure, our courts will continue to treat it as such because of the past". Examples of such cases include *Ben-Tovim v Ben Tovim* 2000 3 SA 118 (T); *Makhavhu v Lukhoto Bus Service (Pty) Ltd* 1987 3 SA 376 (W); *Tenowitz v Tenny Investment (Pty) Ltd* 1979 2 SA 680 (E); *Kotze v Tulryk Bus Service Bpk* 1977 3 SA 118 (T).

19 *Companies Act* 1973:sec. 427.

management to registered companies.[20] It meant that other business entities such as sole traders and partnerships were not eligible to apply for judicial management.[21]

To address the failures of judicial management, Smits recommended that the legislature consider adopting a regime similar to Chapter 11 of the *Bankruptcy Code* 1978 of the United States, which is available to all debtors, irrespective of their legal form or business activities.[22] Smits argued that an entrepreneur could develop into a company. Therefore, there is no need to exclude sole traders and partnerships from business rescue.[23] Kloppers had a different viewpoint. Instead of replacing the whole regime, he maintained that the legislature had to amend judicial management and restrict its application to companies, close corporations, and trusts.[24] Rajak and Henning advocated for a separate informal procedure for small businesses.[25] They maintained that small businesses required a less complicated and cost-effective procedure to remain in business.[26] Judicial management had proved to be cumbersome and expensive for small businesses.[27] Burdette posited that the distinctions between corporations, partnerships, and individuals engaged in business activities are artificial and, in many cases, unnecessary.[28] Thus, Burdette recommended a uniform insolvency legislation that incorporates both natural and juristic persons.[29] It follows that the cabinet approved the drafting of the Insolvency and Business Recovery Bill.

2.2.1.1 Insolvency and Business Recovery Bill

The Standing Advisory Committee on Company Law granted permission to the University of Pretoria's Centre for Advanced Corporate and Insolvency Law to carry out a project aimed at incorporating the liquidation provisions of the Close

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20 A company is defined in sec. 1 of the *Companies Act* 1973 as being a company incorporated under the Act or a company which existed immediately prior to commencement of the Act under any law repealed by it.

21 Loubser 2004:142; see also Levenstein 2015:61.

22 Smits 1999:80-107; see also Smits 1998:59-61.

23 Smits 1999:80-107; see also Smits 1998:59-61.

24 Kloppers 1999:369; see also Kloppers 2001:359-379.

25 Rajak & Henning 1999:270.

26 Rajak & Henning 1999:270.

27 Loubser 2007:156.

28 Burdette 1999:8; see also Burdette 2004b:409-438.

29 Burdette 2002:15. The author makes reference to a conference held on 6 October 1999, which was aimed at considering whether a uniformed legislation would be feasible for South Africa. The conference drew a total of 230 attendees. There was strong consensus at the conference that South Africa should implement a single insolvency statute.

Corporations Act 69 of 1984 and the CA 1973 into the South African Law Commission's Draft Insolvency Bill.[30] This resulted in the Insolvency and Business Recovery Bill 2004 (Bill 2004). The Bill is based on the premise that it is possible to have one Act dealing with all insolvency provisions, despite obvious and not so obvious differences between individuals, partnerships, trusts companies, close corporations, and other legal entities.[31] It would be both practical and good administration to have a single set of provisions governing the administration of all insolvent estates, whether those of individuals or juristic persons.[32] Furthermore, it was believed that unified legislation would eliminate uncertainty and ambiguity in the practice of administering insolvent estates.[33] The Bill provides debt relief schemes for individuals and partnerships and this part provides comments on the proposed schemes.

According to Bill 2004, an individual or partnership in financial distress may propose a composition to its creditors or apply for business administration.

a. Compositions

The Bill proposed incorporating compositions as part of debt relief schemes available to individuals and partnerships.[34] Supporters of this proposition argued that composition before liquidation would save costs, including the liquidation application and appointment of a liquidator.[35]. However, some commentators did not support the idea, maintaining that magistrates do not have the necessary expertise to serve in the role of commissioners while dealing with insolvency issues.[36] In response to this contention, some commentators proposed that the magistrate should be given statutory powers to determine the repayment period. [37] Thereafter, the debtor should be discharged.

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30 Explanatory Memorandum 1999: iv. A working document in the form of a Draft Bankruptcy Bill, was drafted and submitted for discussion at a symposium held at Procforum (Transvaal Law Society) on 23 October 1998.

31 Explanatory Memorandum 1999: iv.

32 Explanatory Memorandum 1999: viii.

33 Explanatory Memorandum 1999: viii.

34 *Insolvency and Business Recovery Bill* 2004: Chapter 26.

35 Roestoff & Coetzee 2012:70-71.

36 Explanatory Memorandum 1999: 237; Explanatory Memorandum 2000: par 124.2.

37 Explanatory Memorandum 1999: 237.

I am of a different opinion from the views expressed by other commentators above. The sole purpose of compositions is to ensure that creditors are paid at all costs. Thus, a proposal for a composition is not concerned with the survival of the debtor but with the recovery of debts. Compositions are not ideal for the recovery of a business operated by a sole proprietorship or partnerships for three main reasons: first, when a sole proprietor proposes a composition or a form of arrangement, it may be interpreted as an act of insolvency.[38] This would automatically nullify the rescue attempt. Second, compositions require a unanimous decision among creditors. If one disagrees, then the whole arrangement falls away. Third, compositions do not guarantee discharge. The debtor remains liable for debts that were not included in the composition and, as such, sequestration proceedings may be commenced by other creditors. I believe that Bill 2004 was not in a position to salvage UBEs, considering the loopholes in its proposal.

b. Business administration

The business administration procedure is provided in Chapter 28 of the Bill 2004. The purpose of business administration is not clear but what is clear is that at any time but before granting a final liquidation order, a debtor may apply for business administration.[39] In terms of the Bill a “debtor” is anyone who is registered as a VAT vendor in terms of the *Value Added Tax Act* 89 of 1991.[40] This means that an individual either operating as a sole proprietorship or forming part of a partnership may apply for business administration. Although the Bill envisions a business rescue applicable to individuals and partners in a partnership, the procedure in its not effective in achieving this goal for the following reasons:

Firstly, the Bill 2004 does not recognise sole proprietorships and partnerships as juristic persons. The problem with this approach is that when a sole proprietorship applies for business administration as an individual, certain adverse consequences follow. For instance, in divorce proceedings, the spouses may litigate to determine whether their marriage was a universal partnership, including the business. [41] This

38 *Insolvency Act* 1936: sec. 8(e). See Chapter 3 for a detailed discussion.

39 *Insolvency and Business Recovery Bill* 2004: sec. 134.

40 *Value-Added Tax Act* 1991: sec. 1 “vendor" means any person who is or is required to be registered under this Act: Provided that where the Commissioner has under section 23 determined the date from which a person is a vendor that person shall be deemed to be a vendor from that date.

41 See *V v V (5508/11)* [2013] ZAGPPHC 530 (17 April 2013).

would mean that courts will have to determine whether the term “debtor” includes the spouses of the business owners. Moreso, treating sole proprietors as individuals allows both personal and business creditors to intervene in the administration process. Concerning individuals who are partners in a partnership, the Bill does not clarify the following issues: the effect of the application on the other partners and the partnership. Whether or not personal creditors are permitted to interfere in the proceedings. In addition, the Bill does not specify whether an insolvent partnership or partnership by estoppel may apply for business administration. This approach exposes the procedure to abuse because partnerships by estoppel are not “debtors” as contemplated by business rescue.[42] This lack of clarity makes the commencement procedure ambiguous and unreliable.

Second, section 135 of the Bill provides that the effect of an application by a debtor for business administration stays civil, liquidation and execution proceedings.[43] The issue with the moratorium provided by the Bill is that it provides a blanket moratorium. If applied in its current form, it will prejudice innocent parties such as children who may need courts to interfere on issues such as paternity tests, custody and maintenance. It may also prejudice spouses who may want to apply for a divorce order, restraining order or address issues arising from domestic violence. Furthermore, co-debtors and guarantors are not protected by the moratorium. If the debtor is placed under business administration, creditors may enforce their claims against the co-debtor and guarantors. This possibility may discourage guarantors and co-debtors from extending administration finance to the debtor.

Third, Bill does not encourage a cramdown of secured creditors.[44] A cramdown is beneficial to the rescue of the debtor in that the amount owed to the creditor is reduced to reflect the fair market value of the collateral used to secure the original debt. Under the proposed Bill the debtor is required to make cash payments for any decline of

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42 See Chapter 2.2.2.

43 *Insolvency and Business Recovery Bill* 2004: sec. 135 states that “ The effect of an application by a debtor for business administration shall be (a) to stay any civil proceedings instituted against the debtor and the directors or others officers of the debtor; (b) to stay any liquidation proceedings in terms of this Act for the liquidation of the debtor; (c) to stay the execution of any judgment which has been granted by any court against the property of the debtor.

44 See further discussion on Chapter 3. *Bankruptcy Code* 1978: sec. 1129(b). The cramdown provision allows a bankruptcy court to ignore the objections of a secured creditor and approve a debtor's reorganization plan as long as it is "fair and equitable."

value in the secured property during the operation of the stay.[45] This defeats the whole purpose of imposing a moratorium on all proceedings. A moratorium is intended to provide a debtor with a breathing space to increase its profits and to treat all creditors equally.[46] The Bill places secured creditors on an unequal footing and indirectly encourages unsecured creditors to object to the application for administration or confirm the implementation of a business administration plan.

Fourth, provisions for formulating a business administration plan are not clear on the treatment of survival debts such as mortgage bills, medical bills and maintenance. These expenses are not even mentioned.[47] Fifth, the administration procedure does not provide a clear exit procedure for the debtor. The ultimate business rescue goal is to guarantee the debtor a fresh start.[48] The Bill only provides for circumstances were the debtor fails to comply with the business administration plan or where the debtor ceases operating its business.[49] This seems to suggest that if a debtor is admitted to business administration, they will not be discharged from the procedure. The Bill raises more questions than answers. Considering that the CA 2008 was later adopted instead of the Bill, it appears that sole proprietorships and partnerships have to rely on the IA 1936 and the NCA 2005. At present, there are no changes to the IA 1936 or the CA 2008 that would accommodate a rescue procedure for sole proprietors or partnerships. The current proposed amendment to the IA 1936 is introduced by the Financial Matters

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45 *Insolvency and Business Recovery Bill* 2004: sec. 138(3) “During the period of the stay provided by the administration order, secured creditors shall be entitled ti adequate protection of the their security by means of cash payments by the debtor for any decline in the value of their security during the duration of the stay.”

46 *Chetty v Hart* [2015] 4 All SA 401 (SCA) para: 28. Cachalia JA held that “[s]ection 128(1)(b) of the Act defines business rescue to mean proceedings that facilitate the rehabilitation of a financially distressed company by providing, amongst other things, for the temporary supervision and moratorium on the rights of claimants, and the development and implementation of a plan to rescue the company. The obvious purpose of placing a company under business rescue is to give it breathing space so that its affairs may be assessed and restructured in a manner that allows its return to financial viability.”

47 *Insolvency and Business Recovery Bill* 2004: sec. 141.

48 Hallinan CG 1986: 53-54 states that “[t]he idea of creating legal devices for the relief of insolvent debtors has ancient antecedents.11 But debtor relief as a primary objective of bankruptcy laws in particular is a decidedly modern and peculiarly American phenomenon. For most of its Anglo-Americancan history, bankruptcy was exclusively a creditors' remedy, a device for equitably dividing an insufficient pool of assets among multiple claimants. To the extent that the remedy afforded the debtor some degree of relief from other varieties of coercive collection, that effect was regarded as merely an incidental by-product of a system single-mindedly focused on advancing the interests of creditors. Even the centerpiece of the modern "fresh start," the bankrupt's discharge from further liability for prebankruptcy debts, was originally conceived not as a relief measure but as a reward for the debtor's efforts to maximize the return to his creditors. Indeed, until well into this century, despite the obvious intent of modern bankruptcy legislation and the empirical realities of consumer bankruptcy filings, respected authorities continued to argue that the protection and payment of creditors was the only legitimate point of permitting legal relief through bankruptcy.”

49 *Insolvecy and Business Recovery Bill* 2004: section 143.

Amendment Bill 2019 are not concerned with the recovery of individuals or partnerships in financial distress.[50]

2.2.1.2 Companies Act of 2008

The CA 2008 is celebrated for its many innovations, including the introduction of the business rescue procedure.[51] One objective of the CA 2008 is to facilitate the efficient rescue and recovery of financially distressed businesses, while balancing the rights and interests of all relevant stakeholders.[52] Hence, the function of the Chapter 6 business rescue process is to oversee the rescue or rehabilitation of debtors experiencing financial difficulties.[53]

The Chapter 6 business rescue procedure is a significant improvement of the judicial management procedure.[54] In *Merchant West-Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd and another*,[55] Kgomo J described the business rescue procedure as being a "novelty" and "innovative". Levenstein stated that the business rescue scheme is concerned with the survival of the business as a going concern rather than a juristic person.[56] In contrast to judicial management, business rescue is concerned with the repayment of debts to creditors and the continuation of the company's operations.[57] For this reason, business rescue

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50 *Financial Matters Amendment Bill* B1:2019 aims to amend, among others, the IA, 1936 to provide that secured creditors holding property pledged as security for the obligations of a South African party arising under a "master agreement" may: immediately realise the property held as security under the "master agreement"; and retain the proceeds of realisation to extinguish the debts owing to the secured creditor under the "master agreement.

51 Cassim ***et al*** 2012:861; see also Anderson 2008:104-211; Kleitman 2014:28; Leppan & Yeates 2010:1-15; Levenstein, 2008:12-14; Mokoena 2019:1-41; Snyman-Van Deventer & Jacob 2014:103; Wassman 2014:36.

52 *Companies Act* 2008:sec. 7k; In *African Bank Corporation of Botswana LTD v Kariba Furniture Manufacturers (Pty) Ltd* [2015] 3 All SA 10 (SCA) it was clearly stated: "The end sought by the business rescue regime in Chapter 6 of the Act is the efficient rescue or rehabilitation of a company that is financially distressed and in doing so, the interests of all stakeholders are to be taken into account."

53 *Companies Act* 2008:sec. 128(b): "business rescue means proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for— (i) the temporary supervision of the company, and of the management of its affairs, business and property; (ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and (iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company."

54 Levenstein 2016:73; see also Stein & Everingham 2011:409.

55 *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd and another* 2013 JDR 1019 GSJ 1: par. 1.

56 Levenstein 2016:73; see also Cassim ***et al*** 2012:862; *Griessel and Another v Lizemore* [2015] 4 All SA 433: par. 78.

57 *Companies Act* 2008: sec. 128(b).

is regarded as an ideal procedure for all types of debtors involved in economic activities.

It appears from case law and legislation that there are three requirements for a debtor to be eligible for business rescue. First, the debtor must operate a legitimate business. Second, the debtor must be creditworthy. Third, the debtor must be registered in terms of the CA 2008. The paragraphs that follow discuss these requirements in detail.

Business rescue is only available to debtors who operate a legitimate business. In *Registrar of Banks v Dafel and others*,[58] the defendant received and deposited money from the general public in violation of sections 17 and 18(a)(i) of the *Banks Act*.[59] Section 17 states that anyone who conducts the business of a bank must be registered as a bank with the Registrar of Banks. A person who is not registered with the registrar is required to obtain authorisation from the registrar pursuant to section 18 (a)(i). In its decision, the court determined that an order to place Dafel into business rescue would only serve to further the illegal activities of the company, while also preventing creditors from enforcing their rights against the debtor.[60] The application to commence business rescue was denied, and the court made it clear that the procedure for business rescue is not available to companies engaged in unlawful businesses.[61]

The available case law emphasises that, for a debtor to qualify for business rescue, the debtor should secure post-commencement finance. In *Southern Palace Investment 265 Pty Ltd v Midnight Storm Investment 386*,[62] the Eloff, AJ held that:

> one would expect an applicant for business rescue to provide concrete factual details of the source, nature and extent of the resources that are likely to be available to the company, as (e) as the basis and terms on which such resources will be available. It is difficult to see how, without such details, a Court will be able to compare the scenario sketched in the application with that which would obtain in an immediate liquidation of the company. Mere speculative suggestions are unlikely to suffice.[63]

In *Helderberg Laboratories CC and others v Sola Technologies*,[64] the court held that the ability of a debtor to pay its debts may be demonstrated by its ability to secure

58 *Registrar of Banks v Dafel and others* 2015 JOL 28714 (GSJ).
59 *Registrar of Banks v Dafel* 2015: par. 28.
60 *Registrar of Banks v Dafel* 2015: par. 43.
61 *Registrar of Banks v Dafel* 2015: par. 43.
62 *Southern Palace Investment 265 Pty Ltd v Midnight Storm Investment 386* 2012 (2) SA 423 (WCC): par. 25.
63 *Southern Palace Investment 265 Pty Ltd v Midnight Storm Investment 386* 2012: par. 25.
64 *Helderberg Laboratories CC and others v Sola Technologies* 2008 (2) SA 627 (C): par. 16.

post-commencement secure finances. In this regard, the creditworthiness of the debtor would assist in the raising of the money. Furthermore, in *Payslip Investment Holdings CC v Y2K TEC,*[65] the court granted an order for business rescue because the applicant relied on a bank guarantee, which was evidence of its creditworthiness. A synopsis of these two cases was delivered by Boqwana J in *Dippenaar and others v Business Venture Investment No. 134 and Another.*[66] The court observed that orders for business rescue were delivered in both cases granted on the basis that both companies demonstrated their creditworthiness. It is evident from these cases that creditworthiness is a fundamental factor in determining whether an applicant is eligible for business rescue. The courts are mainly concerned with the debtor's capacity to secure post-commencement finance.

Another requirement for business rescue is that the debtor must be registered as a company or close corporation.[67] In terms of the CA 2008, a company is only recognised as a company if it falls under one of the three categories: First, a company incorporated in terms of the provision of the CA 2008;[68] second, foreign companies that have transferred their registration to South Africa; And third, those juristic persons incorporated under the legislation repealed by the CA 2008 and entities previously recognised as companies under the provisions of the CA 1973.[69] The act has important implications for close corporations. In particular, no new close corporations can be formed under the *Close Corporation Act* of 1984,[70] and companies cannot be converted into close corporations. All close corporations that existed before the promulgation of the CA 2008 continue indefinitely as juristic persons. Therefore, they are eligible for business rescue under the CA 2008.

The definition of a juristic person does not include UBEs such as partnerships and sole proprietors.[71] I posit that the exclusion of UBEs is mainly based on their lack of separate legal personalities. Companies are clothed with a corporate personality.[72] In

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65 *Payslip Investment Holdings CC v Y2K TEC* 2001 (4) SA 781 (C).

66 *Dippenaar N.O. and Others v Business Venture Investments No 134 (Pty) Ltd and Another* [2014] 2 All SA 162 (WCC).

67 *Companies Act* 2008:sec. 1.

68 *Companies Act* 2008:sec. 1.

69 *Companies Act* 2008:sec. 1.

70 *Close Corporation Act* 69/1984:sec. 2(1) as amended by the *Companies Act* 2008.

71 Cassim ***et al*** 2012:865; Loubser 2007:157.

72 Cassim ***et al*** 2012; Phiri 2020:154; Watson 2019:137-166.

addition, the DTIC decided to exclude other forms of businesses from the application of the new CA 2008.[73] However, partnerships and sole traders can make use of NCA 2005. The following section explains the classification of debtors in terms of NCA 2005.

2.2.1.3 National Credit Act 34 of 2005

The NCA was promulgated in 2005, and after a decade of trial and error, it was amended in 2019. Otto describes the NCA 2005 as an ambitious and perhaps even idealistic piece of legislation with (e)-defined socio-economic goals.[74] In pursuance of these goals, the Act is dedicated to promoting responsible credit marketing, fulfilment of financial obligations by debtors, and discouraging reckless trading by lenders.[75] Its main aim is to prevent over-indebtedness by facilitating the payments of overdue debts.[76] Part D of Chapter 4 of the NCA 2005 deals with over-indebtedness, reckless credit, debt intervention, and debt review. These four regimes are designed to provide debt relief for debtors in South Africa.

Under the NCA 2005, there are three requirements for a debtor to qualify for debt relief. A debtor must not be a juristic person, the value of the assets or annual threshold must not exceed the prescribed threshold of one million, and the type of transaction they have concluded must be credit agreements as defined by the Act.[77] Section 4 provides that the NCA 2005 applies to natural persons and a class of juristic persons.[78] A juristic person is defined in the Act as including a partnership, corporation and UBEs. Section 78 stipulates that Part D of the Act does not apply to juristic persons.[79] This suggests that partnerships are not eligible to apply for debt relief provided in Part D of Chapter 4, and this is not the only limitation of the Act. Debtors are also classified in terms of the type of transaction they have concluded. The Act only applies to credit agreements

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73 GN 1183 Government Gazette 2004:43-45.

74 Otto 2009:272; see also Du Plessis 2007:76-94; Roestoff & Coetzee 2012:67; In *Collett v FirstRand Bank Ltd* 2011 (4) SA 508 (SCA): para 514 stated that "the purpose of the debtreview is not to relieve the consumer of his obligations but to achieve either avoluntary debt re-arrangement or a debt re-arrangement by the Magistrate's Court."

75 *National Credit Act* 2005:sec. 3.

76 Van Heerden & Coetzee 2019:3-4.

77 *National Credit Act* 2005:sec. 4.

78 *National Credit Act* 2005:sec. 4; see also Scholtz *et al* 2008, Chapter 4.

79 Part D of the *National Credit Act* 2005 provides a variety of debt relief schemes including debt review and debt intervention.

between parties dealing at arm's length.[80] Section 4(b) provides a list of instances that are regarded as not dealings at arm's length; these include a loan from a shareholder to a juristic person, a credit agreement between relatives and where a party is not independent of the other.[81]

Besides conducting business at arm's length, the transaction must be classified as a credit agreement. Section 8(2) of the NCA 2005 states that an insurance policy,[82] lease agreement[83] and stokvel loan[84] are not credit agreements for purposes of debt relief. It means that debts arising from transactions identified in section 4(b) and section 8(2) are not affected by the NCA 2005. In other words, a debtor may apply for debt relief but its application may be interrupted by creditors whose debts do not fall under the NCA 2005. From this synopsis, it is clear that the NCA 2005 fails to provide a uniform remedy for sole traders and partnerships; yet, all these business entities need the assistance of debt review or business rescue.[85]

The current classification of debtors in South Africa effectively disenfranchises sole traders and partnerships. In the CA 2008, partnerships are excluded from the application of the Act because they are not legal persons; whereas, in the NCA 2005, they are recognised as legal persons, and for this reason, they do not qualify for debt review. Yet, both sole proprietorships and partnerships are in need of the benefits of

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80 *National Credit Act* 2005:sec. 4(1). This Act applies to every credit agreement between parties dealing at arm's length and made within, or having an effect within South Africa.

81 *National Credit Act* 2005:sec. 4(b): "(i) a shareholder loan or other credit agreement between a juristic person, as consumer, and a person who has a controlling interest in that juristic person, as credit provider; (ii) a loan to a shareholder or other credit agreement between a juristic person, as credit provider, and a person who has a controlling interest in that juristic person, as consumer; (iii) a credit agreement between natural persons who are in a familial relationship and (aa) are co-dependent on each other; or (bb) one is dependent upon the other; and (iv) any other arrangement (aa) in which each party is not independent of the other and consequently does not necessarily strive to obtain the utmost possible advantage out of the transaction; or (bb) that is of a type that has been held in law to be between parties who are not dealing at arm's length."

82 This also includes credit extended by an insurer solely for purposes of payments of premiums on a policy of insurance.

83 *National Credit Act* 2005:sec. 5(2)(b).

84 *National Credit Act* 2005:sec. 1 defines *stokvel* as "a formal or informal rotating financial scheme with entertainment, social or economic functions, which– (a) consists of two or more persons in a voluntary association, each of whom has pledged mutual support to the others towards the attainment of specific objectives; (b) establishes a continuous pool of capital by raising funds by means of the (c) grants credit to and on behalf of members; (d) provides for members to share in profits from, and to nominate management of the scheme."

85 Roestoff & Renke 2003: 1-26. The article examines the extent to which existing South African consumer protection law measures are geared toward preventing problematic debt situations. In conclusion, the authors argue that the existing insolvency and consumer protection laws are inadequate to address individuals' over-debt and overspending, and that legal reform is consequently necessary.

debt reviews or businesses.[86] I opined that the recognition of partnerships as legal persons or an association of natural persons is a matter of convenience. The legislature recognises partnerships as legal persons only when it is in harmony with its intentions for promulgating a particular statute. However, I am of the view that sole traders and partnerships should be treated as separate entities for purposes of business rescue.[87] This proposition is based on the recognition of UBEs as both economic and legal realities. The idea that sole proprietorships and partnerships should be considered as debtors for purposes of business rescue or debt relief is not foreign to South Africa.

As previously mentioned, the exclusion of UBEs from the NCA 2005 and CA 2008 was mainly because they do not have legal personality. In the following discussion, I demonstrate that there are certain instances where the legislature and the judiciary draw a distinctive line between a sole proprietorship and owner, and between partnership and the partner. The discussion is aimed at supporting the idea that legal personality should be extended to UBEs for purposes of business rescue.

2.2.1.4 Sole proprietorships as legal persons

The law of sole proprietorship has not received adequate academic and legislative attention in South Africa. The available literature on this subject provides that a sole proprietorship is a business that is operated and managed by an individual.[88] It is not necessary to register the business, but where necessary, individuals must acquire licenses to conduct business.[89] The liability of the business is the liability of the

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86 With reference to business rescue, Cassim ***et al*** 2012 opined that "despite its name (Business rescue) the provisions of the *Companies Act* 2008 do not apply to unincorporated associations or entities such as sole traders, partnerships or a business trust. Yet all these business entities are as much in need of the benefits of a business rescue process."

87 Lana 2014:321. Hunter 1999:491 stated: "The rescue culture is defined as a multi-aspect concept, having both a positive and protective role, and a corrective and a punitive role. On one level, it manifests itself by legislative and judicial policies, directed to the more benevolent treatment of insolvent persons, whether they be individuals or corporations, and at the same time to a more draconian treatment of true economic delinquents."

88 Harduth 2017:6; "A sole proprietorship is a business that is owned and operated by a natural person and is the simplest form of business entity. The business has no existence (therefore it is not a 'legal person' such as a 'company' as defined in s 1(vi) of the *Income Tax Act* 58 of 1962) separate from the owner who is called the proprietor. The income from such business should be included in the owner's income tax return and the owner is responsible for the payment of taxes thereon." see also Crusto 2009:5; Oehley 2005:7.

89 The South African Sole Proprietorship National Database was established to formalise and summarise certain key aspects of sole proprietorship such as trade names, income tax registration, business purpose and contact details in order to make it easier to present and verify such information.

individual.[90] Unlike a corporation, the business is not separate from its owner.[91] However, there are certain instances where the business is regarded as separate from its owner for specific purposes. For instance, the sole proprietorship can assume a fictitious name, litigate in its own name and claim tax deductions. It does not mean that a sole proprietorship is a legal person. Instead, it is indicative of its existence as a business entity[92] rather than a juridical person. In Indonesia the government recently promulgated the Government Regulation No. 8 of 2021, which regulates the liability of a sole proprietorship.[93] Although Indonesia is not part of this discussion, its reforms suggests a new paradigm i.e the recognision of sole proprietorships as legal persons. The discussion below provides an in-depth discussion of these examples of a similar phenomenon in South Africa. The purpose of this brief discussion is to demonstrate that it is possible to draw a distinctive line between a sole proprietorship and the owner for purposes of restructuring the business.

Small enterprises

The *National Small Business Act* (NSBA 1996) defines a "small enterprise" as a "separate and distinct business entity … managed by one owner or more predominantly carried on in any sector or subsector of the economy".[94] A sole proprietorship is managed by its owner. This implies that under the NSBA, a sole proprietorship is a separate and distinct business entity.

The purpose of the NSBA is to facilitate the creation of the National Small Business Council (hereafter Council) and the Ntsika Enterprise Promotion Agency (hereafter Agency).[95] The main function of the Council is to "represent and promote the interests of small business, with emphasis on those entities contemplated in the National Small Business Support Strategy."[96] In terms of section 10, the Agency is mandated to assist small businesses by facilitating training, advice and counselling to small business

90 See Harduth 2017:6.

91 Harduth 2017:6; see also Crusto 2009:5; Oehley 2005:7.

92 *National Small Business Act* 102/1996: revised schedule 1.

93 A full discussion of this new law is provided by Januarita 2021: 221-231. He argues that "the absence of regulation on liability creates ambiguity and legal uncertainty on the appropriate liability for the new form of company." He further suggests that the legislature may adopt three models include SPLLC with unlimited liability, SPLLC with limited liability, and SPLLC with certain liabilities."

94 *National Small Business Act* 1996:sec. 1.

95 *National Small Business Act* 1996: The preamble.

96 *National Small Business Act* 1996:sec. 3.

owners.[97] It means that natural persons can seek business and financial advice only if they own a small business. An important point from this approach is that to qualify as a beneficiary of the Agency, a natural person must own a business that is separate from his or her personal economic activities.

Trade name

A sole proprietorship can operate under "the name of its owner or it can do business under a fictitious name."[98] The fictitious name is only assumed for purposes of trading.[99] This does not create a separate legal entity but a business entity. Assuming a trading name creates an impression to the public that members of the public are no longer dealing with the owner of the business in his personal capacity but in his capacity as the *agent* of the business. It cannot be denied that in the eyes of the public, a trading name is evidence of the existence of a business that is separate from the owner. In this context, a sole proprietorship exists separately from the owner as a matter of public opinion.

It is not surprising that members of the public even extend credit to the owner of the business under the impression that they are dealing with a business.[100] In *JC Van Der Merwe v Anastaci Projects*,[101] the High Court held that it was the responsibility of the appellant to inform other parties to the contract that he was trading as a sole proprietorship. Unfortunately, not all members of the public are aware of the fact that the owner of a sole proprietorship is personally liable for the debts and liabilities of the business. Since members of the public may not be aware of the legal consequences of extending credit to sole proprietorships, the law of insolvency should provide safety nets through business rescue.

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97 *National Small Enterprises Act* 1996:sec. 10: "The purpose of the Agency is (a) to expand, co-ordinate and monitor the provision of training, advice, counselling and any other non-financial services to small business in accordance with the National Small Business Support Strategy; (b) to provide financial support to service providers that provide the services contemplated in paragraph (a); (c) to consult with any organ of government."

98 Kopel 2017:394.

99 Oehley 2005:7; see also Harduth 2017:6.

100 *JC Van der Merwe v Anastaci Projects* (A668/07) [2012] ZAGPPHC 288 (13 November 2012).

101 *JC Van der Merwe v Anastaci Projects* 2012: par. 34.

Taxation

Under the tax law, the owner of a business and the business (sole proprietorship) are the same person. Therefore, an individual operating a sole proprietorship files tax returns in his capacity as an individual for both the business and his personal earnings.[102] The owner of a sole proprietorship is required to file two separate tax returns. First, it must complete the Income Tax Return (ITR12) which reflects the annual return for individuals.[103] Second, the owner must file provisional tax returns as a provisional taxpayer.[104] On the same note, the sole trader is allowed to claim tax deductions for expenses incurred in generating income for the business.[105] In this regard, the taxpayer may justify its claims as business expenses. For instance, purchasing a delivery vehicle will depreciate over several years.[106] Thus, the owner is allowed to claim tax deductions over four tax years for the vehicle.[107] In this instance, the individual is permitted to claim tax deductions for a business that exists outside his personal activities. In other words, although a sole proprietorship is an extension of its owner, the owner is allowed to claim tax deductions by virtue of the existence of the business. Thus, an individual is only allowed to claim a deduction if it can be shown that he or she operates a business. For this reason, I posit that the owner and the business can be regarded as two separate persons.

Legal proceedings

A sole proprietor can be sued or sue in its own name.[108] Rule 14 (2) of the Uniform Rules of Court provides that "a partnership, a *firm* or an association may sue or be sued in its name."[109] A *firm* is defined as "a business, including a business carried on by a body corporate, carried on by the sole proprietor thereof under a name other than

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102 Kamdar 2015:16-17 commented as follows: "Family-owned businesses aptly fit the definition of 'connected party' and, therefore, it is quite natural that SARS [South African Revenue Service] will target such entities for an audit. SARS will, without exception, aggressively investigate a family business for tax irregularities practised both by the family-business and its employees who are 'connected' to the business."

103 *Income Tax Act* 58/1962:sec. 8.

104 *Income Tax Act* 1962:sec. 8. Tax registration, also known as SARS registration, must be completed within 60 days from when a business begins generating an income. Such returns must be filed by 31 August and 28 February of each year.

105 *Income Tax Act* 1962:sec. 11 and sec. 16.

106 Harduth 2017:6-8.

107 Harduth 2017:6-8.

108 *Two Sixty Four Investments (Pty) Ltd v Trust Bank* 1993 (3) SA 384 (W). See also Moosa 2013:171-172.

109 Uniform Rules of Court 2009: rule 14(2).

his own."[110] A literal interpretation of Rule 14 would mean that a sole proprietorship can institute legal proceedings in its own name. In *Two Sixty Four Investments (Pty) Ltd v Trust Bank*,[111] the court had the opportunity to interpret Rule 14 (1) and (2). The court observed that the rules of court "are designed to solidify and facilitate actions and applications by or against partnerships, firms and associations which at common law cannot generally sue or be sued in their own names apart from the members constituting it."

The court's interpretation was purposive and its conclusion confirms that a sole proprietor can sue or be sued in its own name. This approach was later adopted by Le Roux J in *Mega Flex, 'n Divisie van Sentrachem Bpk en 'n Ander v White River Motor Trading (Edms) Bpk*.[112] Although there are different ways of citing a sole proprietor, recent case law citations show that a sole proprietor should use its trade name and state in brackets that it is a sole proprietor. This does not make a sole proprietorship a legal person, but it is an indication of the legislature's conscious decision to identify a sole proprietorship as an entity for purposes of facilitating litigation proceedings.

Considering that the legislature and the judiciary sometimes treat a sole proprietorship as a separate business entity, I suggest that such distinction should be made for purposes of business rescue. This proposition is based on the following reasons: First, a sole proprietorship stands as an economic reality. This means that it is a business entity capable of generating revenue,[113] paying taxes, creating employment[114] and contributing to the economy.[115] Thus, business rescue should step in as a safety net for entrepreneurs in financial distress. Second, in the eyes of ordinary members of the public, a sole proprietorship is a business entity. For this reason, such members are prepared to extend credit to a sole proprietorship; hence, business rescue will benefit business creditors when the sole proprietorship is in financial distress. Third, a

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110 Uniform Rules of Court 2009: rule 14(2).

111 *Two Sixty Four Investments (Pty) Ltd v Trust Bank* 1993:384.

112 *Mega Flex, 'n Divisie van Sentrachem Bpk en 'n Ander v White River Motor Trading (Edms) Bpk* [1997] JOL 47 (T).

113 SEDA Report 2021:43 stated that SMMEs managed to achieve a turnover of R1.1 billion in 2021.

114 SEDA Report 2021:43 stated that more than 2 292 jobs have been created for the year 2021. The report further stated that economic conditions were not conducive to the creation of new jobs. This is also evident in the number of businesses that could obtain funding. The report focused on informal businesses, which are largely owner-managed.

115 SEDA Report 2021:32: More than 260 000 SMMEs have received assistance from SEDA.

statutory recognition of sole proprietorships as business entities gives effect to the individual's right to choose a trade, occupation or profession.[116] Critics may argue that a distinction between the owner and the sole proprietorship will create a legal person. This distinction does not create a legal person;nstead, it validates the existence of a sole proprietor as a business entity. The owner of the sole proprietorship will remain liable for the debts and liabilities of the business. This view is clearer under the law of partnerships. The following section explains the various circumstances in which a partnership is treated as a legal entity.

2.2.1.5 Partnerships as legal persons

A partnership is an agreement between at least two parties in which they agree to invest money, labour, or skill in stock and carry on business with the goal of sharing both profit and loss.[117] In essence, partners are jointly and severally liable for the debts and expenses of the partnership.[118] This suggests that, in principle, a partnership has no separate legal personality from that of its partners.[119] However, the legislature and judiciary have noted instances where it is convenient to deal with the partnership as a single entity rather than the individual partners.

The main reason for the exclusion of partnerships from business rescue and debt relief is related to their legal personality. As explained above, under the CA 2008, a partnership does not qualify for business rescue because it is not a juristic person. However, in terms of the NCA 2005, a partnership is a legal person that qualifies for

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116 Constitution 1996:sec. 22 states: "Every citizen has the right to choose their trade, occupation or profession freely." The practice of a trade, occupation or profession may be regulated by law. Section 22 of the Constitution must be read as a corrective to historical employment and trade inequities created by Apartheid. In *JR 1013 Investments CC and Others v Minister of Safety and Security and Others* 1997 (7) BCLR 950 980B E (E), Jones J noted: "We have a history of repression in the choice of a trade, occupation or profession, this resulted in disadvantage to a large number of South Africans in earning their daily bread. In the pre-Constitution era implementation of the policies of apartheid directly and indirectly impacted upon the free choice of a trade, occupation or profession: unequal education, the prevention of free movement of people throughout the country, restrictions on where and how long they could reside in particular areas, and the practice of making available structures to develop skills and training in the employment sphere to selected sections of the population only, and the statutory reservation of jobs for members of particular races. The result was that all citizens in the country did not have a free choice of trade, occupation or profession. Section 22 is designed to prevent a perpetuation of this state of affair."

117 Davis *et al* 2019:410; see also Henning 2014a:23-25; *Pezzuto v Dreyer* 1992 (3) 379 (A): 390D.

118 Davis *et al* 2019:410; see also Henning 2014a:152 who stated that "[t]he rights and duties of the partnership are the rights and duties of the partners, and its property is owned in common by the partners in undivided shares." *Sacks v CIR* 1946 AD 31:40; *Muller v Pienaar* 1968 (3) SA 195 (A):202-203.

119 Henning 2014a:150. The current view in South Africa is that partnerships are a collection of individuals with no separate identity. This approach is subscribed to the aggregate theory. See also Barrett & Seago 1956:13; Bromberg & Ribstein 2000:1:19-1:20; Heenen 1984:14-17; Scamell & Banks 1984:32.

debt relief if its annual turnover or net asset value does not exceed the threshold of one million. I am of the view that since partnerships are regarded as legal entities for certain purposes, they should also be recognised as such for business rescue. There are numerous instances in which a partnership is recognised as a legal entity under South African legislation[120] and case law.[121]

KwaZulu Natal Partnership Act

The idea that partnerships are sometimes enjoy limited liability is not novel in South Africa.[122] Limited partnerships were created in terms of the Cape *Special Partnerships Limited Liability Act* of 1861[123] and the Natal *Special Partnerships Limited Liability Act* of 1862.[124] Generally, a limited partnership is the statutory counterpart of the partnership en commandite under common law.[125]

The partnership *en commandite*, which originated in the European *ius commune*, provides the non-managing partners with limited liability.[126] The partner *en commandite* is not answerable to the firm's creditors, but only to his other partners, to whom he is only liable for his proportionate share of partnership losses up to the

120 Henning & Snyman 1997:684. In this article the authors provided a detailed analysis of the developments in US legislation, the *Revised Uniform Partnership Act* of 1997, in which the law has moved to embrace the entity theory of partnership. It is noted that South Africa has failed to make changes with regard to the law of partnerships. Later in another article, Henning 2014b:53-66 identified legislation that have embraced the entity theory.

121 *Bristowe J in Potchefstroom Dairies and Industries Co Ltd v Standard Fresh Milk Supply Co* 1913 TPD 506:513-514 held that "I do not think, however, it makes much difference whether we regard a partnership as a persona or whether we regard it as a contractual compound of several personae. And the distinction between the two seems more academic than substantial. I am, however, prepared to go to the extent of holding that a partnership, though not a corporate individual, is analogous to a personal that it may be called quasi-persona. This seems to me to be an accurate statement of the law deductible from recent cases. For many purposes it has, or is treated as having a persona of its own, and particularly in relation to commercial transactions is this a convenient and succinct way of regarding its position." See *also Sacks v Commissioner for Inland Revenue* 1946 AD 31*; Standard Bank of SA v Lombard* 1977 (2) SA 808 (W); *Strydom v Protea Eiendomsagente* 1979 (2) SA 206 (T); *Standard Bank of SA Ltd v Pearson* 1961 (3) SA 721 (E); *Muller v Pienaar* 1968:202-203.

122 See an indepth exposition by Hennings 2015: 251–275.

123 *Partnership Limited Liability Act* 24 of 1861, amended by the Cape *Special Partnerships Limited Liability Amendment Act* 12 of 1906.

124 *Special Partnerships Limited Liability Act* of 1862 Enacted by Law 1 of 1865, of which section 14 provided: "The Law shall be cited for all purposes as '*The Special Partnerships Limited Liability Act*, 1864.

125 Hahlo & E Kahn 1960: 699 cited by Hennings 2015: 251.

126 Hennings 2015: 251–275.

amount of his agreed capital contribution.[127] Thus, a partner *en commandite* is protected from the partnership's creditors, and his liability is limited.[128]

Despite the reception of the partnership en commandite and its recognition as a characteristic of South African law, the Cape and Natal Acts were implemented in the two colonies.[129] Although the limited partnership was not widely adopted, and the Cape and Natal enactments were subsequently overturned in South Africa, the significance of these colonial acts in the context of South African partnership law should not be overlooked. It is important to remember that these colonial statutes are the only stand-alone, contiguous partnership legislation ever adopted in South Africa. Nonetheless, in certain instances the legislature treats all partnerships whether ordinary or limited liability partnership as juristic persons.[130]

Civil proceedings

A partnership is recognised as a legal entity for purposes of civil proceedings.[131] During the subsistence of a partnership, creditors may sue all of the partners jointly and severally for the payment of partnership debt.[132] In this regard, judgement is rendered against the partnership estate and not the partners in their personal capacities.[133] In other words, execution of judgement must be first levied against the assets of the partnership. A partnership may bring suit in its own name or be sued in its own name. If a judgement is entered against the partnership without disclosing the identity of any of the partners, execution may be levied against the partnership's property.[134] In *DF Scott (EP) Pty Ltd v Golden Valley Supermarket*,[135] Harms JA held that Magistrates' Court Rule 54 deals with procedural and not substantive law. Hence, this does not

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127 Hennings 2015: 251–275.

128 Hennings 2015: 251-275

129 Hennings 2015: 251-275.

130 The study does treats partnerships as homogenous entities to provide at least a starting point. Hence, not all types of partnerships are addressed in the business rescue model.

131 Cilliers et al 2009:150-154. See also Standard Bank of SA v Lombard 1977:831; *Strydom v Protea Eiendoms-agente* 1979:209; *Standard Bank of SA Ltd v Pearson* 1961:721; *Muller v Pienaar* 1968:202-203.

132 David & Geach 2019:420; see also Henning 2014a:156; *Herbst v Solo Boumateriaal* 1993 (1) SA 397 (T); *Parker v Rand Motor Transport Co* 1930 AD 353; *Press v Barker* 1919 CPD 243; *Matterson Bros v Rolfes, Nebel & Co* 1915 WLD 33.

133 *Supreme Court Act* 59/1959:sec. 26(2); see also Supreme Court rules: rule 14(5)(h); Magistrate Court Rules rule 40(3*); Farmfare (Pty) v Fairwood Supermakert* 1986 (4) SA 258 (C): 262A; *Cupido v Kings Lodge Hotel* 1999 (3) All SA 578 (EC):582.

134 Rule 14 of the *Uniform Rules of Court*; see also *Ahmed v Belmont Supermarket* 1991 (3) SA 809 (N).

135 *DF Scott (EP) Pty Ltd v Golden Valley Supermarket* 2002 (6) SA 297 (SCA).

transmogrify a partnership or firm into a separate legal entity or juristic person who is separate from its members.[136]

Consumer Protection Act 68 of 2008

The *Consumer Protection Act* (CPA 2008) includes a partnership or association in its definition of a juristic person.[137] The term *person* also includes a juristic person.[138] In turn, the term *juristic person* includes a partnership. The purpose of the CPA is to protect consumers from unfair business practices[139] and provide access to an efficient redress system for consumers.[140] The CPA applies to all business transactions concluded in South Africa.[141] In other words, the rights and privileges of consumers guaranteed by the CPA are enjoyed by both natural and juristic persons, including partnerships.

Income Tax Act 58 of 1962

Under the *Income Tax Act* of 1962, a partnership is not regarded as a legal entity distinct from its members for purposes of assessment.[142] However, in terms of the *Valued Added Tax Act* 89 of 1991, a partnership is regarded as carrying on business in the capacity of a distinct and separate person from its members.[143] It is required to obtain a separate value added tax registration number for its operations. The partnership must be registered separately from any other enterprise in which its members are registered.[144] Furthermore, the partnership's liability for value added tax must be determined and calculated separately from any other business activity carried

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136 *Rees v Feldman* 1927 TPD 884:889.

137 *Consumer Protection Act* 68/2008:sec. 1.

138 *Consumer Protection Act* 2008:sec. 1.

139 *Consumer Protection Act* 2008:sec. 1: "Consumer, in respect of any particular goods or services, means— (a) a person to whom those particular goods or services are marketed in the ordinary course of the supplier's business; (b) a person who has entered into a transaction with a supplier in the ordinary course of the supplier's business, unless the transaction is exempt from the application of this Act by section 5(2) or in terms of section 5(3); (c) if the context so requires or permits, a user of those particular goods or a recipient or beneficiary of those particular services, irrespective of whether that user, recipient or beneficiary was a party to a transaction concerning the supply of those particular goods or services; and (d) a franchisee in terms of a franchise agreement, to the extent applicable in terms of section 5(6)(b) to (e)."

140 *Consumer Protection Act* 2008:sec. 3.

141 *Consumer Protection Act* 2008:sec. 5. "(1) This Act applies to— (a) every transaction occurring within the Republic."

142 *Income Tax Act* 58/1962; see also *Chipkin Natal Pty Ltd v Commissioner for SARS* 2005 (3) All SA 26 (SCA); *Commission for Inland Revenue v Epstein* 1954 (3) SA 689 (A):699; Sacks v CIR 1946:40.

143 *Income Tax Act* 89/1991:sec. 51(1).

144 Henning 2014a:165.

on by its members.[145] Since a partnership is constituted, *intuit personae*, in other words, the *delectus personarum* is regarded as one of the main considerations on which an agreement of partnership rests; any change in membership destroys the identity of the firm.[146] However, in terms of section 51(2), if a partnership is dissolved because one of its partners withdraws or a new partner is added, but the new partnership continues to carry on the enterprise as a going concern, the new and the dissolved partnership are deemed as one and the same partnership.[147]

Law of insolvency

Before the promulgation of the *Insolvency Act* 24 of 1936 (IA 1936), partnerships were recognised as legal entities separate from the partners for purposes of insolvency.[148] This position was maintained in the IA 1936. A partnership or the estate of a partnership is included in the definition of a debtor under the Act. Other provisions of the Act treat a partnership as if it were a separate legal entity from the individuals who form it.[149] The trustee of the partnership estate is entitled to the partnership's residue only after all creditors have been paid in full.[150] Similarly, the trustee of a partner's estate is entitled to the residue of the partnership estate after all claims against the partnership have been paid in full.[151] It effectively separates the insolvency procedures of partners and that of the partnership.

In terms of section 92(5) of IA 1936, separate accounts must be kept for each partner in the partnership estate.[152] This demonstrates that third parties dealing with and

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145 *Income Tax Act* 1991:sec. 51(1): "The statutory duties and obligations imposed on a partnership must be performed separately from the duties of and obligations imposed on any of its members."

146 *Executors of Paterson v Webster Steel &* Co (1881) 1 SC 350:355. "There can be no doubt that as a general principle the court can only recognise the members of which the firm consist and that any change among them destroys the identity of the firm."

147 *Value Added Tax Act* 1991:sec. 51(2).

148 *Gcilitschana v General Accident Assurance Co SA Ltd* 1985 (2) SA 367 (C); see also *Pretoria Hypothec Mpy v M& D Golombick* 1906 TH 51: 52; *De Vries Marais v Hollis* 1882 1 SAR 25:26; In *Ehrig & Weyer v Transatlantic Fire Insurance Co* 1905 TS 557:560, it was held that "[a] firm may for some purposes be treated as having a separate identity".

149 *Insolvency Act* 1936:sec. 2; 3(2),13,49,92(5).

150 *Insolvency Act* sec. 49; see also *Ex parte Cohen* 1974 (4) SA 674 (W); *Mischalow v Premier Milling Co Ltd* 1960 (2) SA 59 (W).

151 *Insolvency Act* 1936:sec. 92(5) states that "if the estates of a partnership and of a partner are under sequestration simultaneously, the administration of the former must be kept separate from the latter and separate accounts must be framed for each estate"; *Cassim v The Master* 1962 (4) SA 601 (D): 606; *Blackhodge (Rhodesia) Pvt) Ltd v Duff NO* 1961 (2) SA (SR).

152 *Insolvency Act* 1936:sec. 92(5); see also Bertelsmann *et al* 2008:602; Henning 2014a:153.

lending to a partnership believe they are dealing with a separate and distinct entity.[153] It follows that when a partnership is sequestrated, creditors are limited to the partnership's assets and are automatically barred from seeking recourse against individual partners.[154] In *Cassim v The Master,*[155] the court confirmed that under the insolvency law, as long as the partnership estate's liabilities exceed the value of its assets, it is treated as a separate entity. The best interests of the creditors' enquiry were discussed in *Gardee v Dhanmanta Holdings*.[156] It was held that in an application for the sequestration of a partnership and of the partners, the debtor contemplated by section 10(c) of IA 1936 is the partnership and it alone.[157] What must be considered under this provision is whether there is a reason to believe that the sequestration of the partnership estate would be to the advantage of the partnership's creditors.[158]

It is argued that it is in the best interests of a partnership's creditors to evaluate whether business rescue may save the partnership or yield a better return for the creditor. If the business rescue procedure is successful, partnership creditors stand a chance of receiving their returns in full. However, if there are no prospects of recovery, at least a better return can be achieved. Besides the laws of insolvency, tax and civil procedures, there are numerous examples where the legislature recognises a partnership as a legal entity.[159] Therefore, it is logical to recognise the partnership estate as a separate entity for purposes of business rescue. The partnership estate may be evaluated to establish if business rescue is a viable alternative to liquidation.

A business rescue scheme may serve the best interest of creditors better than insolvency proceedings. Instead of selling the assets of the partnership as piecemeal, business rescue can facilitate the maximisation of the assets of the partnership. There is a suggestion that a partnership can make a valid composition and be reinvested

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153 *Mischalow v Premier Milling Co Ltd* 1960 (2) SA 59 (W):62; see also *Ex parte Cohen* 1974 (4) SA 674 (W); *Cassim v The Master*: 606; *Gaardee v Dhanmanta Holdings*: 1071.

154 Henning 2014a:153; see also Sharrock 2007:207-208.

155 *Cassim v The Master* 1962 (4) SA 601 (D):606.

156 *Gardee v Dhanmanta* 1978 (1) SA 1066 (N):1067.

157 *Gardee v Dhanmanta* 1978:1068.

158 *Gardee v Dhanmanta* 1978:1068.

159 *Credit Rating Services Act* 24/2012:sec. 1; see also *Legal Practice Act* 28/2014:sec. 7*; Financial Markets Act* 19/2012:sec. 1; *Gambling Act* 7/2004:sec. 1; *Private Security Industry Regulation Act* 56/2001:sec. 1; *Financial Institutions (Protection of funds) Act* 28/2001:sec. 1. *Mutual Banks Act* 124/1993:sec. 1; *Banks Act* 94/1990:sec. 1; *Customs and Excise Act* 91/1964:sec. 103; *Export Credit and Foreign Investments Insurance Act* 78/1957:sec. 1.

with its assets though it ceases to exist when its estate is sequestrated at common law.[160] Sharrock attempted to dismiss this suggestion by stating that the position is probably that a new partnership takes the place of the old one, which dissolves on the sequestration of its estate.[161] Compositions have the same idea as business rescue; hence I am convinced that it is necessary to respond to Sharrock's viewpoint. The purpose of business rescue is to make arrangements for payment of outstanding debts and where possible to allow the injection of new capital. If this results in the formation of a new entity, then business rescue was a success. In essence, business rescue is not concerned about the legal form of the business but the going concern. However, considering the complexity of the law of insolvency on partnerships I concur with Rajak and Henning[162] who suggested that a separate business rescue scheme is needed for small businesses. Policies and practices in other jurisdictions may provide a useful direction for the legislature in South Africa.

2.2.1.6 Summary

The law of insolvency relating to sole trader and partnerships is regulated in terms of different statutes. These statutes include the IA 1936, NCA 2005, and CA 2008. These legislation provide debt relief schemes and business rescue regimes that are meant to assist debtors in financial distress. However, the classification of debtors in the current legislation does not accommodate UBEs.

Part D of Chapter 4 of the NCA 2005 only applies to sole traders. Moreover, the CA 2005 only applies to specific contracts that fall within the ambit of the Act. It means that even though a sole trader and partnerships may make use of the NCA 2005, creditors arising from other contracts not regulated in terms of the Act may apply for sequestration proceedings. In other words, the NCA 2005 in its current state cannot effectively facilitate debt relief for sole traders and partnerships.

The CA 2008 provides business rescue for debtors in financial distress. Nonetheless, only companies and close corporations are eligible to apply for business rescue. The company law review specifically excluded the law of partnership and sole

160 *Gain NO v Parker & Son* 1933 CPD:75.
161 Sharrock 2007:207.
162 Rajak & Henning 1999:270.

proprietorships. Thus, South Africa does not have legislation that facilitates debt relief or business rescue for UBEs.

The reason for the exclusion of sole proprietorships and partnerships from the application of business rescue or debt relief seems to be that they are not legal persons. However, there is legislation that recognises sole traders as business entities separate from their owners. For instance, a sole trader is recognised as a business entity in the NSBA 1996; a sole trader can also claim tax deductions for business expenses and in legal proceedings, and it can litigate in its own name. As for partnerships, the general rule is that a partnership is regarded as an association of persons. Nevertheless, there are exceptions to this rule. A partnership is recognised as a legal entity in legal proceedings, taxation and insolvency procedures. For this reason, I suggest that sole traders and partnerships should also be recognised as legal entities for purposes of business rescue. Lessons can be drawn from practices in other countries.

2.2.2 United States of America

The US bankruptcy system offers the best example of a rescue procedure that is available to all forms of business structures regardless of their economic activities and legal personality.[163] Its business scheme has a rich history stemming from the railroad failures in the nineteenth century.[164] The *Bankruptcy Act* of 1867 and 1898 introduced the concepts underpinning the US modern bankruptcy law.[165] These laws, especially the *Bankruptcy Act* of 1898, were founded on rescue and rehabilitation policies.[166] The

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163 American Bankruptcy Institute Commission Report 2015:7; see also Acharya *et al* 2011:150; Loubser 2007a:449; Warren & Westbrook 2009: 604-642.

164 Korobkin 1991:747-749; Skeel 2001:281.

165 Lubben 2014:319-425; Mayson 2019:55; Jacobvitz 2019:1-3 states that "The first bankruptcy law in the United States was enacted in 1800, eleven years after ratification of the U.S. Constitution, but was repealed three years later. It was passed in response to financial crises in 1792 and 1797. The *Bankruptcy Act* of 1800 was very similar to English bankruptcy law. It was very pro creditor oriented. Only involuntary bankruptcy cases were allowed, and only merchants could be debtors. To obtain a discharge from debts, two thirds of creditors by number and value of claims had to consent to the discharge."

166 Under the *Bankruptcy Code* of 1978, Chapter 11 became the sole vehicle for businesses to file bankruptcy, but also provided for the reorganisation of individuals. *Bankruptcy Reform Act* of 1978, Pub. L. No. 95-598, tit. IV, section 401(a), 92 Stat. 2682 (1978). Previously, Congress created Chapters 10 and 11 of the Bankruptcy Code through the *Chandler Act* of 1938. The *Chandler Act* created Chapter 10 for publicly held companies and Chapter 11 for non-publicly held businesses.

Bankruptcy Act of 1898 sought to balance the debtor's need to be rehabilitated with the creditor's right to receive returns.[167]

The *Bankruptcy Code* of 1978 is based upon this rescue culture. The Code has three business reorganisation schemes: Chapters 11, 12 and 13. It is important to point out that the *Bankruptcy Code* 1978 is governed by federal laws and applies in the United States, irrespective of the state within which a reorganisation petition has been filed.

Since 1978, Chapter 11 has been amended by *the Bankruptcy Abuse Prevention and Consumer Protection Act* of 2005*[168]* and Sub-Chapter V entitled the *Small Business Reorganisation Act* of 2019 (*Reorganisation Act* 2005).[169] It is envisaged that a large number of small businesses in the United States will apply for business reorganisation under the *Reorganisation Act* 2005 after the COVID−19 pandemic.[170] Fortunately, the *Reorganisation Act* 2005 has received positive reviews confirming its suitability to facilitate quick and cost-effective recovery of small businesses.[171]

Before discussing the details of the 1978 *Bankruptcy Code*, I must briefly explain the available courts for lodging petitions for business reorganisation orders.[172] The proper venue for lodging a business reorganisation petition is the district court,[173] where the debtor resides or conducts business. At the district court, the judge has the power to refer the matter to a bankruptcy judge.[174] If a petitioner desires to appeal against the bankruptcy court's decision, it may approach the district court or the bankruptcy appellate panel.[175] In cases where litigants are not satisfied with the district court's decisions or the bankruptcy appellate panel, they can appeal to the district circuit court

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167 This work does not outline the history of U.S. bankruptcy laws, as this has been done well and extensively outlined by previous scholars; see also Skeel 2001:281; Tabb 1991:344-369, 1995:18-23.

168 *Bankruptcy Abuse Prevention and Consumer Protection Act* of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of the Bankruptcy Code).

169 The new Subchapter V to Chapter 11 for small business reorganisations became effective from 19 February 2020.

170 Janger 2020:254-266; Pena 2020:1.

171 *In re Ventura United States Bankruptcy Court*, E.D. New York. April 10, 2020, 615 B.R: 1, Grossman J held that "[b]y enacting the Small Business Reorganization Act of 2019 which added subchapter V to Chapter 11 of the Bankruptcy Code, Congress intended to streamline the reorganisation process for small business debtors because small businesses have often struggled to reorganise under Chapter 11."

172 *Chapter 4: Institutional Framework* contains a full discussion of the hierarchy of courts and the role of the judiciary.

173 *Bankruptcy Code* 1978:sec. 1408.

174 *Bankruptcy Amendment and Federal Judgeship Act* of 1984.

175 *Bankruptcy Code* 1978:sec. 158(a); *Wellness Intern. Network, Ltd. v. Sharif*, 135 S.Ct. 1932, 191 L. Ed. 2d 911 (2015).

(courts of appeal). The courts of appeal have appellate jurisdiction only after the bankruptcy and district courts have issued final orders.[176] The decisions of the appeal courts are binding on the lower court. However, the US Supreme Court decisions are binding on all courts, including appeal courts and lower courts. Consequently, the US Supreme Court decisions are final, whereas decisions of the lower court may be overturned on appeal to the US Supreme Court. The discussions that follow explore the different business reorganisation procedures available in Chapters 11, 12 and 13 of the *Bankruptcy Code* 1978,[177] focusing on the eligibility criteria for debtors.

2.2.2.1 Chapter 11 – Reorganisation scheme

A business in financial distress may apply for business reorganisation in terms of Chapter 11.[178] The primary objective for allowing debtors to reorganise in terms of Chapter 11 is to save jobs, increase creditors' returns and preserve businesses that contribute to the economy.[179] Chapter 11 defines a debtor as an individual, partnership or corporation that resides or is domiciled or has a place of business or property in the United States.[180] It means that any debtor is eligible for the reorganisation provided in Chapter 11. Unfortunately, the *Bankruptcy Code* does not define the terms *individual* and partnership. The following discussion explores the meaning of an individual involved in economic activities and the status of the insolvent partnership.

Debtors as a sole proprietorship

Chapter 11 allows individuals involved in economic activities to apply for business reorganisation.[181] Does this mean a sole proprietorship is a debtor separate from its

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176 *Bush v United States*, 939 F. 3d 839 (7th Cir. 2019).

177 *Bankruptcy Code* of 1978 as amended by the *Bankruptcy Act* of 2005 and the *Reorganisation Act* of 2019.

178 Lawless & Warren 2005:743-750; Gilson 2012:23 states that "Despite longstanding criticism of Chapter 11 by economists and businessmen as too costly, slow, or inequitable, recent experience suggests that the legal process—including the people who advise, manage, and finance distressed companies—has evolved and adapted to deal with this brave new world of large, complex cases. New legal strategies, new ways of financing distressed companies, and increases in the experience and sophistication of the participants have all helped make the U.S. restructuring process much more efficient than it was 20 years ago."

179 *In re: CWNEVADA LLC* United States Bankruptcy Court, D. Nevada. June 3, 2019 602 B.R: 717; American Bankruptcy Institute Commission Report 2015:4 "The utility of the chapter 11 process is important not only for companies that file Chapter 11 cases, but also for companies trying to achieve an out-of-court resolution. Distressed companies and their stakeholders frequently consider the federal bankruptcy alternative in deciding whether to pursue or ultimately agree to an out-of-court restructuring plan." See also Klee 1979:133-134; Posner 1997:47-126. Lopucki & Whitford 1993:599 explained the success of business reorganisation.

180 *Bankruptcy Code*:sec. 109(d), read with sec. 101(41).

181 *Luciano Prologo v Flagstar Bank, Fsb* United States District Court, D. Maryland. March 16, 2012, 471 B.R. 115. Ellen Lipton Hollander, J., held that "[i]ndividuals may file bankruptcy petitions under Chapter 11, whether or not they are engaged in business as sole proprietors".

owner for business reorganisation? The Bankruptcy Court *In re Doris A. Christenberry (e)a Little Pigeon Roost* provided guidelines in answering this question.[182] In this case, Doris applied for business reorganisation in terms of Chapter 11 on behalf of her business which she operated as a sole proprietor.[183] Her application for business reorganisation was later converted to liquidation proceedings in terms of Chapter 7 of the *Bankruptcy Code*. The bankruptcy proceedings meant that her business and her estate would be liquidated. She then instituted a motion to dismiss bankruptcy proceedings for her personal estate. In her application for dismissal, she submitted that her application for business reorganisation was for the business (Little Pigeon Roost) and not her personal estate.[184] The legal question before the court was whether the term *debtor* in Chapter 11 encompasses a sole proprietor. The court held that a sole proprietorship is "[a] form of business in which one person owns all assets of a business in contrast to a partnership and corporation. The sole proprietor is solely liable for all the debts of the businesss".[185] With that established, the court stated that a sole proprietorship is not a *person* for purposes of the *Bankruptcy Code*. Since a sole proprietorship is not an individual, partnership, or corporation, it is ineligible to be a debtor in bankruptcy.

Consequently, an individual who applies for business reorganisation in terms of Chapter 11 should initiate the proceedings in his own name and not the name of the business. This view is illustrated in *Altchek v Altchek (In re Altchek).*[186] The court reiterated that in a Chapter 11 application for business reorganisation on behalf of the business, the debtor's estate includes the natural person's estate and the estate of the business.[187] The court reasoned that an individual owns a sole proprietorship. Therefore, a sole proprietorship does not have any interests besides the interests of its owner.[188] This case seems to suggest that when assessing the viability of placing

182 *In re Christenberry* 336 B.R. 353 (Bankr. E.D.Tenn 2005).

183 *In re Christenberry* 2005: par. 1.

184 *In re Christenberry* 2005: par. 1.

185 *In re Christenberry* 2005 par. 2; *State v Pendergrass* Bankr. E.D.Tenn. 2005 13 S.W.3d 389, 395 (Tenn.Ct. Crim.App. 1999).

186 *Altchek v Altchek (In re Altchek),*124 B.R. 944, 955-56 (Bankr. S.D.N.Y.1991).

187 Altchek 1991:955.

188 *In re T.W. Koeger Trucking Co.,* 105 B.R. 512, 515 (Bankr. E.D.Mo.1989).

a sole proprietorship under Chapter 11, the personal debts and liabilities of the proprietor are evaluated together with the debts and liabilities of the business.

The court would have reached a different conclusion had it considered the reasoning of Crusto.[189] Crusto argued for the recognition of sole proprietorships as legal entities.[190] He further proposed the *Limited Liability Sole Proprietorship Act*[191] to regulate the recognition of sole proprietors as legal entities. Custro discussed the recognition of sole proprietorships in the light of criminal law. He challenged the current view that sole proprietorships are inseparable from their owners, based on two cases decided in the Indiana Court of Appeal. I will now narrate and comment on these cases with a view of justifying the recognition of sole proprietors as legal entities capable of suffering economic loss and viable for business rescue.

The first case was heard in the Indiana Court of Appeal, *Mc Kinley v State.*[192] The Indiana Court of Appeal held that a sole proprietorship and the owner are separate entities.[193] In this case, the appellant and an accomplice entered Norwasldo Pharmacy and ordered the store clerk and the wife of the owner of the store to empty the cash register. He then ordered the owner (Mr Herman) to turn over the store money and his personal wristwatch. The appellant was charged with and convicted of two counts of armed robbery. On appeal, the appellant contended that the robbery of the shop owner's personal belongings and the store only constituted one armed robbery. The appellant based its argument on the "single larceny doctrine"[194] as applied in *Williams v State*.[195] The Indiana Court of Appeal did not accept the appellant's contention. Hunter J held that in *William,* the defendant was found guilty of one count of robbery although he robbed four cashiers in a bank. The single larceny doctrine applied because the defendant had robbed a single business establishment. Concerning the appellant's case, the court found that the appellant was guilty of two counts of robbery

189 Crusto 2001:381; see also Crusto 2009:215-275.

190 Crustor 2009:239.

191 Crusto 2001:381. See also proposals by Klee 1997:431-452.

192 *Mc Kinley v State* 400 N.E.2d 1378 (Ind 1980).

193 *Mc Kinley v State* 1980:689.

194 Single larceny doctrine is a principle of criminal law that taking of different items of property belonging to either the same or different owners at the same time and place, constitutes one act of larceny if the theft is part of one larcenous plan.

195 *Williams v State*, (1979) Ind. 395 N.E.2D 239: In this case, the defendant robbed a bank by ordering four clerks to surrender money in their cash draw. The defendant was found guilty of a single count of robbery based on the single larceny doctrine.

since he robbed Mr Herman's personal belongings and store money. In essence, a sole proprietorship is a business establishment. "There was no express requirement that the business entity [should] be a separate 'person' as is a corporation or partnership."[196] Hence the appellant "wronged an individual by robbing both the individual and that individual's business".[197]

The same approach was taken by Barnes J in *Pagan v State.*[198] The court held that the proprietor and the business were distinct entities. In this case, the defendant robbed a video store by threatening the proprietor with a knife and demanded money from her purse and cash register. The video store was operated independently. The defendant was charged with and convicted of armed robbery. On appeal, the defendant contended that the State failed to establish that Hardinsburg Video was a *person* susceptible to robbery because the Indiana Criminal Code does not expressly define a *person* to include a sole proprietorship. The court held that a sole proprietorship might qualify as a person under the Indian Criminal Code, relying on the *McKinley* decision.

It is essential to note that neither *McKinley* nor *Pagan* required the recognition of a sole proprietorship as a distinct legal entity. The court in *McKinley* viewed the robbery as two distinct crimes intended to injure the same person. According to the court, after the defendant stole money from the cash register, his actions changed when he directed the store owner to retrieve his wallet and wristwatch. The court did not rely on any concept or doctrine of legal personality in upholding the two convictions. The court made no requirement that the business operated as a distinct legal entity, such as a corporation.[199] The court determined that the defendant's actions resulted in multiple types of injuries to a single individual. In the *Pagan* case, the court cited *McKinley* to support the proposition that a sole proprietor can be a crime victim apart from its owner. However, the distinction stems from *McKinley*'s recognition that a single business owner can be a robbery victim in two distinct ways.

In both cases, the sole proprietorship is recognised as a business entity capable of suffering an economic loss. In this case, the loss was a result of the robbery. Although

196 *Mc Kinley v State* 400 N.E.2d 1378 (Ind 1980):691.
197 *Mc Kinley v State* 1980:691.
198 *Pagan v State* 809 N.E.2d 915 (Ind. Ct App. 2004).
199 *McKinley v State* 1980:691.

a sole proprietorship is inseparable from its owner from a legal perspective, it is a distinct and separate entity from an economic point of view. In other words, legal personality is not a necessity for a going concern to be regarded as a business entity or business establishment.[200] Therefore, I suggest that when evaluating the viability of placing a sole proprietor under business reorganisation, the personal debts and liabilities of the proprietors should be separated from the debts and liabilities of the business.

Debtors as a partnership

The *Bankruptcy Code* 1978 provides that a debtor can also be a partnership that is domiciled or has its place of business or assets in the United States.[201] This part establishes whether an insolvent partnership is a legal person for purposes of the Chapter 11 business reorganisation.

Partnership separate from partners

It appears that a partnership that applies for business reorganisation in terms of Chapter 11 is recognised as a separate entity. In *Aboussie Bros Constr. Co v United Mo Bank* [202] the United States District Court, E.D. Missouri, Eastern Division held that "a partnership is a separate and distinct entity from its partners for bankruptcy purposes."[203] In that case, Aboussie Brothers Construction Company was in financial distress, for instance, due to the personal guarantees made by the partners for the partnership. The partnership applied for Chapter 11 reorganisations, which resulted in the automatic stay of most of the actions against the partnership and its property.[204] However, the United Missouri Bank filed suit against Edward and Louis in their capacities as individuals. (Edward and Louis Aboussie were the only partners of Aboussie Brothers Construction Company.) The suit was based on the guarantees of the debts of the partnership by the individual partners. The court was called upon to

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200 In *McKinley v State* 1980:691, Hunter J remarked: "Our holding in *Williams v State* was couched in terms of 'business establishment' and the 'business's money.' There was no express requirement that the business entity be a separate 'person' as is a corporation or partnership."

201 *Bankruptcy Code* 1978:sec. 101 read with sec. 109; see also Hurt ***et al*** 2014:9-11; Neely 2000:534.

202 *Aboussie Bros Constr. Co v United Mo Bank (In re Aboussie Bros Constant Co*) 8 B.R. 302, 303 (E.D. Mo. 1981).

203 *In re Aboussie Bros Constant Co* 1981 at 303; see also In *Re Jercyn Dress Shop*, 516 F. 2d 864 (2d Cir. 1975); *First Nat. Bank of Herkimer v Poland Union*, 109 F. 2d 54 (2d Cir. 1940); *Nat. Bank v Bear*, 276 U.S. 215, 48 S.Ct. 252, 72 L.Ed. 536 (1928).

204 *Bankruptcy Code* 1978:sec. 362.

decide whether the moratorium in bankruptcy extended to the partners in their personal capacities. The partners argued that allowing the United Missouri Bank to sue the partners would result in the depletion of resources, which would hinder the possibility of a successful reorganisation of the debtor. More so, contributions by partners were necessary for the recovery of the partnership. However, this could not be possible since they were being sued. The court held that it is generally accepted that a partnership is a separate legal entity for purposes of business reorganisation under Chapter 11.[205] Hence, it may be adjudged bankrupt irrespective of the bankruptcy of the individual partners.[206]

Therefore, the estate of a partnership and the estates of the individual partners that constitute the partnership are two separate entities for purposes of business reorganisation.[207] The assets of each partner do not form part of the partnership estate that files for business reorganisation.[208] Conversely, when an individual files for debt relief, the partners' interests in the partnership becomes an asset to the individual partner's case.[209]

Partnership by estoppel

A partnership is created in the ordinary course of business by reaching a consensus, either verbal or written agreement.[210] Through agreement, parties agree to the terms

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205 *In re Aboussie Bros Constant Co* 1981:303, Nangle J held that "[there is] no reason why the distinct existence of the partnership and its partners should be disregarded in the instant context. This Court may stay suits against the Debtor's property, not that of the individual partners of the Debtor. It is, of course, true, that execution upon the judgment against Edward and Louis Aboussie may impair their ability to contribute funds to the reorganization of the Debtor. Adverse effect upon the Debtor, alone, however, is not sufficient justification for the exercise of jurisdiction over the property of the partners."

206 *In re Aboussie Bros Constant Co* 1981:304.

207 *Bankruptcy Code* 1978: sec. 541(a). Under section 541(a)(1), the estate of a partnership debtor includes "all legal or equitable interests of the debtor in property as of the commencement of the case", subject to the exclusions in § 541(b) (including powers exercisable solely for the benefit of another and interests as lessee of nonresidential real property terminated through expiration of the lease term) and (c)(2) (beneficial interests in "spendthrift trusts."

208 *Official Comm. of Unsecured Creditors v. Ashdale (In re Labrum & Doak*, LLP), 227 B.R. 391, 404-12 (Bankr. E.D. Pa. 1998), appeal dismissed, 1999 WL 667280, 667284, 667285 (E.D. Pa. Aug. 26, 1999) the court held that the estate of dissolved law partnership includes share of income earned by debtor's former partners after dissolution in matters originated during their tenure with firm and billed on hourly, non-contingent fee basis because, under Pennsylvania version of UPA, absent contrary agreement, partners of dissolved partnership owe fiduciary duty to wind up firm's unfinished business without additional compensation).

209 *In re Baldwin* 593 F.3D 1155, 52 Bankr. Ct. Dec, (CRR) 189 (10th Cir 2010); see also *In re Palumbo*, 154 B.R. 357, 358 (Bankr. S.D Fla. 1992). The court held that assets of a partnership are not to be administered in a partner's bankruptcy proceedings since a partnership is a separate entity from its partners under bankruptcy law.

210 *In re TAYLOR & ASSOCIATES, L.P* United States District Court, E.D. Tennessee. March 28, 1997249 B.R. 431; For general partnership to exist, there must be evidence of intent among the alleged partners to do the things which constitute a partnership; such evidence would show that each party recognized, accepted, or

and conditions of the partnership, including sharing of profits and losses.[211] Nevertheless, under the doctrine of partnership by estoppel,[212] it is not necessary to prove that a partnership existed to hold a party liable to third parties as a partner of a partnership with which the third parties have contracted.[213] In general, a partner has ostensible authority if he or she appears to be authorised to act on behalf of the partnership to the outside world.[214] When liability arises, the other partners are estopped from denying that the partnership existed.[215] This legal phenomenon raises the question of whether a partnership by estoppel can be a debtor for the purpose of business reorganisation in Chapter 11.

The *Bankruptcy Code* 1978 provides that a partnership may be a debtor under Chapters 7, 11 and 12. The House Report stated that a partnership by estoppel is not eligible for relief under the *Bankruptcy Code*.[216] In *In re Indvik*,[217] the partners by estoppel applied for exemption under Chapter 7. The Court held that the debtors (petitioners) were estopped from denying the existence of the partnership, and even if it did not exist, they could not claim partnership assets as exempt in their Chapter 7 cases. It appears that a partnership by estoppel is not eligible to apply for liquidation in Chapter 7, since the business reorganisation process in Chapter 11 is meant to assist existing businesses. It is posited that partnership by estoppel does not qualify for business reorganisation because the partners already sought to deny the existence of the partnership.

understood its own contribution to the business relationship, as well as acknowledged the contribution of other parties, as part of joint effort.

211 *Western Assur. Co., Inc. v Connors*, 830 F. Supp. 1191 (S.D. Ind. 1993); *In McDowell v. McDowell*, 2004 WL 892107 (Tex. App. San Antonio 2004); *Hansford v Maplewood Station Business Park,* 621 N.E.2d 347 (Ind. Ct. App. 5th Dist. 1993).

212 *Uniform Partnership Act* 1997: sec. 308(a) Callison & Sullivan 2020:5.26; see also *Best Cartage, Inc. v Stonewall Packaging, LLC*, 727 S.E.2d 291 (N.C. Ct. App. 2012); *O'Brien & Gere Engineers, Inc. v Taleghani,* 525 F. Supp. 750 (E.D. Pa. 1981).

213 *Landreth v Raymond P. Fabricius, P.C.,* 109 N.E. 3d 225 (Ill. App. 3d Dist. 2018).

214 Davis *et al* 2011:338; *Reinhart v Boeck,* 918 N.E. 2d 382 (Ind. Ct. App. 2009).

215 *Carpenter v Rohrer*, 2006 ND 111, 714 N.W.2d 804 (N.D. 2006).

216 House Report 1977 No 595, 9th Congress 1st session: 197.

217 *In re Indvik,* 118 B.R. 993, 1003 (Bankr. N.D Iowa 1990).

Partnership in dissolution

A partnership may be subject to dissolution if the other partner decides to withdraw from the partnership or dies. In *C-TC 9th Avenue Partnership v Norton Co*,[218] United States Court of Appeals, Second Circuit, held that a partnership in dissolution is not a debtor for the purpose of business reorganisation under Chapter 11.[219] In so holding, the court relied on the law of partnerships in New York and the purpose of business reorganisation under Chapter 11. Under New York law, a partnership is created by two or more persons as partners. When one of the partners dies or withdraws from the partnership, the dissolved partnership is permitted to continue operating until all its affairs are concluded.[220] This posed the question: What is the meaning of the word *continue*? The Court referred to the finding in *Pastor v State Ta Comm(e)*[221] where the Appellate Division held the following:

> …section 61 of the New York Partnership Law operates *not* to "prolong the life of an otherwise unviable entity" but only to allow [the] continuation of the partners' liability for debts of the partnership.

Based on this interpretation, a partnership in dissolution is restricted to activities that are aimed at dissolving rather than rehabilitating the partnership.[222] The court further held that the purpose of Chapter 11 is to resuscitate a debtor in financial distress.[223] Thus, although liquidation is permitted in Chapter 11, "there is no reason a debtor should be permitted to enter these proceedings without the possibility of reorganisation."[224] For this reason, the court held that a partnership in dissolution is not a *person* as contemplated in section 109 of the *Bankruptcy Code* 1978 and therefore cannot file for business reorganisation in Chapter 11.[225]

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218 *C-TC 9th Avenue Partnership v Norton Co. (In re C-TC Avenue Partnership*), 113 F.3d 1304, 1307-09 (2d Cir. 1997).

219 *In re C-TC Avenue Partnership* 1997:1305..

220 Makoff 2017: 1551 provides that "…the majority of state partnership statutes provide for a presumption of perpetual existence-the exit of any partner does not automatically dissolve the firm."

221 *Pastor v State Tax Comm'n,* 115 A.D.2d 144, 146, 495 N.Y.S.2d 515 (N.Y.App.Div.1985).

222 *In re C-TC Avenue Partnership* 1997:1309.

223 *In re C-TC Avenue Partnership* 1997:1309.

224 *In re C-TC Avenue Partnership* 1997:1309.

225 *In re C-TC Avenue Partnership* 1997:1309.

The finding *In C-TC 9th Avenue Partnership* seems to contradict the decision of the Supreme Court in *Toibb v Radloff*.[226] The Supreme Court held that an individual not involved in economic activities is eligible for business reorganisation. It implies that a partnership under dissolution should be allowed to apply for business reorganisation as a *person* who has no motive to continue in business. In *In re C-TC 9th Avenue Partnership,* the Second Circuit stated that

> in *Toibb*, the court was determining whether being an ongoing business was a requirement for eligibility for Chapter 11. Whereas the court had been called to determine] what the term "person" encompasses.[227]

There remains a gap as to whether a debtor in Chapter 11 should have the motive to remain in business. It is an issue since individual debtors who are not engaged in economic activities can also apply for business reorganisation under Chapter 11. In the case of *In re Fitzgerald Group*,[228] the United States Bankruptcy Court, S.D. New York, held that the proper function of Chapter 11 is not to facilitate liquidation proceedings. The court dismissed an application for Chapter 11 by a dissolving partnership, stating that

> when determining the appropriateness of this case in Chapter 11 proceedings, the Court has considered the underlying purpose of Chapter 11 which is to rehabilitate the debtor and offer a fresh start. The debtor in this case is a partnership that has been dissolved by the death of a partner. There can be no opportunity to rehabilitate an entity that, by law, no longer exists except for the purposes of liquidation. This debtor seeks relief under Chapter 11, *a reorganization chapter,* when there is nothing which can be reorganized.[229]

From the decision *In re Fitzgerald Group*, it is clear that when a partnership is in dissolution it has no legal option other than to liquidate. The dissolution of a partnership is not calculated to preserve any part of the business but distribute its assets to creditors. For this reason, a partnership in dissolution is not a debtor for the purpose of Chapter 11. *In re Hagerstown Fiber Limited Partnership*,[230] the court developed "a bright light test". In terms of this test, a debtor who applies for business reorganisation

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226 *Toibb v Radloff* 501 U.S. 157, 111 S. Ct. 2197, 115 L. Ed. 2d 145, 21 Bankr. Ct. Dec. (CRR) 1296, 24 Collier Bankr. Cas. 2d (MB) 1179, Bankr. L. Rep. (CCH) 73994 (1991).

227 *In re C-TC Avenue Partnership* 1997:1310.

228 *In re Fitzgerald Group,* 38 B.R. 16 (Bankr.S.D.N.Y.1983). This matter predates the Supreme Court's decision in *Toibb v Radloff* 1991.

229 *In re Fitzgerald Group* 1983:39.

230 *In re Hagerstown Fiber Limited Partnership* November 3, 1998 226 B.R. 35333 Bankr.Ct.Dec. 494.

in Chapter 11 "must have a legal option to continue in business".[231] Thus, a partnership in dissolution is not eligible to apply for business reorganisation not because it seeks to reorganise or liquidate but because there is no legal option to continue in business.

A different approach was taken *In re Foxridge Limited* Partnership.[232] The US Bankruptcy Court, W.D. Missouri, Kansas City Division held that:

> Upon dissolution of a limited partnership, and until a certificate of cancellation is filed, the general partner may file civil suits on behalf of the partnership. The filing of a Chapter 11 bankruptcy petition is analogous to filing a civil suit on behalf of the partnership. Thus, Benchmark [on behalf of Foxridge Limited Partnership] had the standing to file this Chapter 11 bankruptcy petition.[233]

Therefore, in the state of Missouri, a partnership in dissolution is an entity eligible for business reorganisation in Chapter 11. The court's reasoning in this *In re Foxridge Limited Partnership* does not take into consideration the purpose of Chapter 11. Instead, the court justified the eligibility of a partnership in dissolution based on the nature of the proceedings. Although business reorganisation forms part of civil proceedings, the procedure has far-reaching consequences on the rights of third parties, such as creditors.

In re Middletown Metro Associates,[234] Lucius Pettingill and Thomas Kaneconcluded a general verbal partnership. They traded as Middletown Metro Associations.[235] During the subsistence of the partnership, creditors filed for Chapter 7 compulsory liquidation proceedings.[236] After seven months, the partners were discharged. The estate's trustee abandoned the partnership interest to the care of the partners, Pettingill and Kane.[237] At this stage, Shawmut Bank held a security mortgage on the partnership property. The partners decided to discuss refinancing and debt restructuring with Shawmut Bank.[238] However, Shawmut Bank sold its loan to a third party. The third part filed a complaint in Middle Superior Court to foreclose its mortgages but withdrew the matter. Petting and Kane then applied for business reorganisation under Chapter

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231 *In re Hagerstown Fiber Limited Partnership* 1998:358.
232 *In Foxridge Limited Partnership* 238 B.R 810, 8120 (Bankr W.D Mo 1999).
233 *In re Foxridge Limited Partnership* 1999:238.
234 *In re Middletown Metro Associates* 225 B.R 281 (Bankr. D Conn. 1998).
235 *In re Middletown Metro Associates* 1998:281.
236 *In re Middletown Metro Associates* 1998:281.
237 *In re Middletown Metro Associates* 1998:281.
238 *In re Middletown Metro Associates* 1998:282.

11 as Middletown Metro Associates.[239] The court held that a partnership that is dissolved when its partners become Chapter 7 debtors, is reconstituted as a new partnership when the trustee abandons the interests of the partnership to the partners.[240] The court further held that the partners were discharged and had continued running their business.[241] Therefore, the partnership was no longer in dissolution. Subsequently, Middletown Metro Associates was eligible to apply for business reorganisation under Chapter 11.[242]

I concur with the findings *In re Foxridge Limited Partnership* that partnerships in dissolution are eligible for business reorganisations under Chapter 11. Partnerships in dissolution should be allowed to apply for business reorganisation because the purpose of business reorganisation is twofold. First, business reorganisation is aimed at restructuring the debtor's affairs so that the debtor may operate on a solvent basis.[243] Basically, the first objective of business reorganisation is the continuance of the business. Second, if the debtor cannot be rescued, a better return for creditors must be achieved.[244] This suggests that a partnership in dissolution should be allowed to apply for Chapter 11 to maximise its assets for creditors and other relevant stakeholders. In *In re Shea & Gould,*[245] United States Bankruptcy Court, S.D. New York, in Garrity J, remarked that notwithstanding the Second Circuit's Comments in *CTC 9th Avenue Partnership*,[246] a partnership in dissolution is eligible for a Chapter 11 case if its goal is liquidation and not reorganisation.[247] Another business rescue scheme applicable to sole proprietorships and partnerships is housed in Chapter 12 of the *Bankruptcy Code* 1978.

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239 *In re Middletown Metro Associates* 1998:282.

240 *In re Middletown Metro Associates* 1998:282.

241 *In re Middletown Metro Associates* 1998:282.

242 *In re Middletown Metro Associates* 1998:282.

243 Kuney 2004:98; see also Belcher 1997:12; Jackson 1986: Chapter 9.

244 Similar provisions in South Africa and Australia suggest that there are two goals for business rescues. *Bidald Consulting v Miles Special Builders; Bidald Consulting v Miles Special Builders* [2005] NSWSC 1235, Campbell J held that "[t]he object of this Part is to provide for the business, property and affairs of an insolvent company to be administered in a way that: (a) maximises the chances of the company, or as much as possible of its business, continuing in existence; or (b) if it is not possible for the company or its business to continue in existence—results in a better return for the company; creditors and members than would result from an immediate winding up of the company."

245 *In re Shea & Gould*, 214 B.R. 739, 38 Collier Bankr. Cas. 2d (MB) 1453 (Bankr. S.D. N.Y. 1997).

246 *C-TC 9th Avenue Partnership* 1997:1305.

247 *In re Shea & Gould* 1997:739.

2.2.2.2 Chapter 12 – Bankruptcy code

Chapter 12 provides a business rescue framework for debtors belonging to a specific industry and embraces all forms of business entities. For the purpose of this study, Chapter 12 stamps the idea that debtors may be classified in terms of their industry, and the legislature should consider evaluating the efficiency of an industry-based business rescue scheme.

The origins of Chapter 12 can be traced back to the *Federal Farm Bankruptcy Act* of 1934, also known as the *Frazier Lemke Act*. The Act was enacted as part of a congressional initiative to help the agricultural sector recover from the effects of the Great Depression.[248] Its main goal was to limit the banking sectors' ability to reclaim farms by delaying foreclosure of bankrupt farmers, while the debtors restructured their finances.[249] The *Frazier Lemke Act* imposed a five-year moratorium on the sale of farms. [250] Throughout the five years, the debtor kept possession of the farm and paid the bank rentals. If the farm was sold, the debtor could buy it back at one per cent interest over a six-year period. [251] The *Frazier Lemke Act* was challenged in *Louisville Joint Stock Land Bank v Radford,* [252] and the Supreme Court ruled that it was unconstitutional because it violated the creditor's right to due process. [253] The *Frazier Lemke Act* was amended by Congress, delaying the bank's right to foreclose for three years.[254] In *Wright v Vinton Branch of the Mountain Trust Bank*,[255] the Supreme Court upheld the new changes. The Act expired in 1944, even though it was enacted to address the economic problems caused by the Great Depression.

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248 Aiken 1987:632; Anderson 1987:40-41; Sensenich 2016:1-8.

249 Aiken 1987:632; Haber 1987:8-11; Sensenich 2016:1-8 explains that "[d]uring the 1980s farmers across the country were caught between falling land values and the inability to borrow money to finance their farming operations. As land values fell, lenders refused to extend credit to farmers whose land values had fallen to the point where it provided insufficient equity to secure existing loans. The situation made it impossible for many farmers to finance needed equipment purchases or even the planting of crops. Many farms were going out of business as a result of this credit crunch. This put pressure on Congress to find a remedy to help farmers reorganize."

250 Duft 1990:4; Innes *et al* 1989:28-31.

251 Keller & Carman 1989:31; Duft 1990:4.

252 *Louisville Joint Stock Land Bank v Radford*, 295 U.S. 555 (1935).

253 *Louisville Joint Stock Land Bank v Radford* 1935:854.

254 Congress responded by enacting the revised *Frazier–Lemke Act* and naming it the *"Farm Mortgage Moratorium Act*" in 1935.

255 *Wright v Vinton Branch of the Mountain Trust Bank*, 30 U.S. 440, 470 (1935).

In 2005, Congress decided to make Chapter 12 a permanent part of the *Bankruptcy Code*.[256] Chapter 12 forms part of the *Bankruptcy Code* 1978 as a procedure tailored to reorganise commercial farmers.[257] From a micro-perspective of the legislation, Congress intended to provide a business rescue scheme for debtors who are involved in farming activities.[258] From a macro-view of the Act, the primary objective was to slow down the rapid liquidation of farms and salvage the agricultural sector.[259]

The version of Chapter 12 introduced different features from the former version of 1986. Originally, Chapter 12 only allowed farmers to apply for bankruptcy if their debt was equal to or exceeded $1.5 million or if more than 80 per cent of their debt emanated from operating the farm.[260] However, in the current version of Chapter 12, both the minimum and farm-related debt percentages were broadened to increase the eligibility of farmers.[261] In its current form, Chapter 12 defines a *family farmer* as an "individual whose aggregate debts do not exceed $3,544,525 and not less than 50 per cent of whose aggregate non-contingent, liquidated debts arise out of a farming operation owned or operated by such individual."[262] Chapter 12 can be described as a sector-based business rescue scheme. For debtors to qualify for reorganisation under Chapter 12, their businesses must relate to farming activities or at least its debts must be incurred in the course of operating a farming business. The legal personality of the business does not matter. Sole proprietorships, partnerships, cooperatives and companies all qualify for reorganisation if they own or operate a farm. Chapter 12 does not define a family farmer or provide an exhaustive list of farming activities. It has led courts to apply their discretion in determining who qualifies for Chapter 12 relief. Below is a discussion of some of the cases that answer the question: Who qualifies for Chapter 12 relief? I will answer this question in three categories: The first category deals with persons and legal entities eligible for Chapter 12. The second category focuses on the scope of the farming operations, and the third, farming debts related to inheritance and divorce. In short, for a debtor to qualify for Chapter 12, there are three

256 Schneider 2006:310.

257 *Bankruptcy Code* 1978: Chapter 12.

258 Quinn 2017:247; Tayman 2020:81-95.

259 Quinn 2017:247. Tayman 2020:81-95.

260 *Bankruptcy Act* 1986:sec. 251.

261 *Bankruptcy Code* 1978:sec. 101(18); Garcia & Sensenich 2019:14; Schneider 2006:310. Commenting on the new approach, farm income levels have fallen ~34% 2012-2016, debt levels of the early 1980s are back, and real estate value of agricultural operations is skyrocketing.

262 *Bankruptcy Code* 1978:sec. 101(18)(A).

requirements: the debtor must not exceed 3 500 000 million, the debtor must be involved in farming operations, and the debts must have been incurred for farming purposes.

Debtors eligible for debt relief

The first requirement is that the debtor must be a family farmer. In terms of section 101(17), a *family farmer* may include a natural person or an entity.[263] A family farmer can be an individual, a corporation or a partnership.[264] This means that the natural person involved in farming activities is eligible for Chapter 12.

In *In Re Schaurer Agricultural Enterprises*,[265] the district court in Ohio held that farmland owned by an individual or joint family members is eligible for relief in Chapter 12. However, such a debtor must comply with the requirements of a *family farmer* prescribed in section 101(17)(B). This means that a family operation owned by several natural persons in the same family qualifies for Chapter 12 relief. In that case, the court ruled that the family operation was a partnership and that family members were members of the partnership. The court further observed that the family owned the farming equipment itemised in the partnership agreement for purposes of the family business. The court concluded that a partnership involved in farming operations is eligible for Chapter 12 relief, even though the partners are not bankrupt.

In re Victorious[266] the Bankruptcy Court was called upon to decide whether a limited liability company with one shareholder was eligible for Chapter 12 relief. The court observed that the debtor was involved in the fishing business, but it had no operating income. Its main source of finance was the sole shareholder. The debtor's financial statement showed that the debtor recorded nothing as income for three years and did not file any tax returns. The court ruled that it must be a natural person or a company for a debtor to be eligible for Chapter 12 relief. The debtor must be involved in farming or fishing activities as pronounced in sections 101(19B) and 109(f). However, the debts leading to the need for relief must emanate from the farming or fishing business. The court further held that the debtor was a family fisherman. Since he had no regular annual income from the business, he did not qualify under Chapter 12. These and

263 *Bankruptcy Code* 1978:sec. 101(17).
264 *Bankruptcy Code* 1978:sec. 101(17).
265 *In Re Schaurer Agricultural Enterprises* (1988, BC SD Ohio) 82 BR 911).
266 *In re Victorious*, *LLC*, 545 B.R. 815, 62 Bankr. Ct. Dec. (CRR) 49 (Bankr. D. Vt. 2016).

other examples discussed in this part buttress the assumption that Chapter 12 is available to individuals, partnerships and companies who operate farms for purposes of making a profit.

Farming operations

The second and most essential requirement is that the debtor must be engaged in farming operations to be eligible for Chapter 12. The Bankruptcy Court recently directed that an interpretation of the term *farming operations* must be construed liberally to further the purpose of Chapter 12, that is, to help family farmers to continue farming.[267] The *Bankruptcy Code* 1978 provides that *farming operation* includes farming, soil tillage, dairy farming, ranching, the production or raising of crops, poultry, or livestock, as (e) as the unmanufactured production of poultry or livestock products. This list is not exhaustive, and courts have to examine each case in light of its merits. After establishing that the debtor is engaged in farming operations, the debtor's income must exceed 50 per cent of its gross income for the taxable year in the year preceding its filing for bankruptcy.[268] Although Congress was prescriptive on the amount of annual income, it was not possible to provide an exhaustive list of farming operations that the debtor may conduct. This has led litigants to seek clarity from the courts. The courts held that the activities in question constituted farming operations in the following cases.

In *In Re Wolline*[269], the debtor was engaged in dairy farming in conjunction with the business of training horses for riding. The court held that the debtor was eligible for Chapter 12 relief since its business in its diversity was inseparable from the farming operations. Thus the debtor was a *family farmer*" in terms of section 101(17) of the *Bankruptcy Code* 1978. The court reasoned that non-agricultural sources such as leasing horses formed part of the farming operations. In reaching its judgement, the court considered the following: the debtor managed the farming operations; he bred a substantial portion of his horses; and the crops on the farm were used to feed horses and dairy cattle. The debtor provided a comprehensive annual income report and tax returns. The court concluded that all the debtor's activities were inseparably depended

267 *Bankruptcy Code* 1978:sec. 101(21); see also *In re Perkins*, 563 B.R. 229 (Bankr. W.D. Ky. 2016).

268 *Bankruptcy Code* 1978:sec. 101(18); see also *In re Olson*, 609 B.R. 339, 68 Bankr. Ct. Dec. (CRR) 26 (Bankr. D. Mont. 2019).

269 *In Re Wolline* (1987, BC ED Wis) 74 BR 208, CCH Bankr L Rptr 71871.

upon each other so that the debtor was a family farmer entitled to be included under the umbrella of Chapter 12. This is a typical example of a family farmer involved in farming operations with diverse sources of income. The debtor, in this case, operated his farm for both domestic and commercial purposes, hence qualifying for Chapter 12.

It seems that the courts are more concerned with individuals involved in commercial farming. In *In re Myrstol-Snyder*,[270] the debtor was involved in raising chickens and selling eggs in the local market. The debtor averred that she had also survived on selling horses for about five years. The court accepted that raising chickens and selling horses formed part of the operations as contemplated by Congress, but the debtor had failed to provide federal income tax returns. The debtor further pleaded that she had planted a garden and was raising pigs. The court held that these other activities were primarily for personal consumption as such she was not eligible for Chapter 12 relief, not subsistence farming.[271] In other words, Chapter 12 is only meant for commercial farming.

Commercial farming may include many other economic activities. It is easy to apply the *farming operations* test when the debtor is involved in some kind of farming. However, it may be difficult to ascertain whether the debtor is eligible for Chapter 12 relief when the debtor is operating a farming business and engaged in other entrepreneurial activities. The courts have had the opportunity to decide on such an enquiry. The first case involves a debtor who operates a farming business and other business ventures in *re Douglass*. [272] In this case the debtor inherited a service station, which he used to apply for a loan to keep the farm operating on a solvent basis. The loan was secured by mortgaging the service station. The amount of the loan was large enough to allow the debtor to apply for Chapter 12 relief. But since the service station was used as collateral, (e) court had to decide whether a debtor involved in other business ventures was eligible under Chapter 12. The *In re Douglass* case was the first case; hence, the court was not bound by any precedent, instead, it developed one by creating a two-factor test. The first question being: What was the purpose of incurring the debt? And secondly: How was the amount used? The court held that

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270 *In re Myrstol-Snyder,* 530 B.R. 850 (Bankr. D. Mont. 2015).

271 *Bankruptcy Code* 1978:sec. 101 (18)(A), 109(f); see also *In re Myrstol-Snyder*, 530 B.R. 850 (Bankr.D. Mont.2015).

272 *In re Douglass* United States Bankruptcy Court, W.D. Missouri, Central Division. September 11, 1987 77 B.R. 714 16 Bankr. Ct.Dec. 456.

taking into consideration that a non-farm property secured the debt, the burden on proof lied with the debtor. The debtor was required to prove that the loan was used for the farming operations. The court accepted the debtor's submissions that the loan was meant to preserve the farming operations. The nature of the debt's collateral was not dispositive even though mortgaged service stations are different and separate from farming operations.

From the cases discussed above, it is clear that the debtor may be involved in diverse farming activities. However, farming operations must be conducted for commercial and not subsistence farming. Furthermore, a debtor who is engaged in farming operations and other commercial activities may be allowed to apply for Chapter 12 relief only if the debts incurred are for farming activities. Due to length and time constraints, I could not discuss the Chapter 12 rescue process in the remaining chapters of this thesis. Other academics and legislature can explore the chapter.

2.2.2.3 Chapter 13 – Bankruptcy code

Chapter 13 is different from Chapter 11 and Chapter 12 in that it offers business reorganisation for sole traders and persons with regular income.[273] The main difference is that the provisions in Chapter 13 are designed to suit the needs of individuals who are burdened with the liability to pay business creditors and personal creditors. [274] The eligibility criterion for Chapter 13 can be divided into two separate components: the debtor must be an individual and the individual must have a regular income.

Individual

An individual who qualifies for a bankruptcy case is recognised as a debtor in a Chapter 13 case. However, the applicant must also meet the prescribed requirements in section 109(e) of the *Code*. The court must first determine whether the petitioner is an individual. The *Bankruptcy Code* does not define the term *individual*. Drake suggests that the best way to determine the meaning of the term *individual* for purposes of Chapter 13 is to eliminate other inconsistent meanings based on section

[273] Kaplan & Meisel 2017-2018:5.2; see also Norton 2019:17.10.
[274] Kaplan & Meisel 2017-2018:5.

101(30) of the *Bankruptcy Code.*[275] Section 101(30) states that a *person* includes individuals, partnerships and corporations.[276] Hence, by negative implication, section 101(30) shows that an individual is not a partnership[277] or corporation.[278] Section 101(14) also provides another valuable clue; it provides that an *entity* includes a person, estate and government unit.[279] Thus, the *Bankruptcy Code* 1978 defines the term *individual* by negativing many possible definitions, including estates and trusts.[280] The result is that an individual is a natural person. This meaning is consistent with the general meaning of the term *individual* and is in harmony with the intentions of Chapter 13 legislatures.[281]

Debtors who derive an income from the operation of a business as a sole proprietorship[282] qualify for business reorganisation under Chapter 13. If a debtor dies after filing the petition, eligibility is not an issue; the focus is on whether the bankruptcy estate can be further administered and whether the continuation of the Chapter 13 case is in the best interest of the parties in the case.[283] An individual operating a business in corporate form cannot invoke *alter ego* or *veil-piercing* theories to treat the corporation's assets and liabilities as belonging to the individual.[284] In general, individuals for the purpose of Chapter 13 also refer to sole proprietorships.

Partnerships

Since the *Bankruptcy Code* 1978 permits individuals involved in economic activities to file for reorganisation under Chapter 13, an issue arises on whether a husband and wife may be regarded as individuals or as partners. This issue remains significant because the term *individual* does not include spouses. More so, partnerships are not eligible for Chapter 13 cases.[285] It seems Congress anticipated that cases of such a

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275 Drake & Morris 1983:205; Tayman 2020:81-95.

276 *Bankruptcy Code* 1978:sec. 101(30).

277 *In re Shead, 59 Collier Bankr. Cas*. 2d (MB) 1074, 2008 WL 1995373 (S.D. Tex. 2008).

278 *Matter of La Cache Land Co., Inc*., 54 B.R. 629 (E.D. La. 1985); see also *In re Agrinsoni*, 2012 WL 2411887 (Bankr. D. P.R. 2012).

279 *Bankruptcy Code* 1978:sec. 101(14).

280 *In re Estate of Gray ex rel. Gra*y, Bankr. L. Rep. (CCH) P 82068, 2011 WL 3946729 (E.D. Mich. 2011).

281 Dreher *et al* 2013:13.6; House Report 1978:311-312.

282 *In re Bradley,* 18 B.R. 105, 7 Collier Bankr. Cas. 2d (MB) 119 (Bankr. D. Vt. 1982); Pearson, 773 F.2d 751, 753, 13 Collier Bankr. Cas. 2d (MB) 749, Bankr. L. Rep. (CCH) P 70787 (6th Cir. 1985).

283 *Federal Rule Bankruptcy*: 1016; see also *In re Terry*, 2015 WL 1321486 (Bankr. E.D. Pa. 2015).

284 *In re Legette*, 2015 WL 4507678 (Bankr. D. S.C. 2015*); In re Lane*, 215 B.R. 810 (Bankr. E.D. Va. 1997).

285 Kaplan & Meisel 2017-2018:5.

nature may be filed; hence, attempting to provide the bankruptcy courts with some guidance to resolve an issue or issues that may arise provided the spouses involved in the business are also debtors.[286]

The amount of guidance that the courts can derive from this statement is questionable.[287] Kennedy opined that courts are instructed to examine whether the petitioners' assets exist for the benefit of all creditors or only for business creditors.[288] The problem is that the House Report does not provide guidelines. In essence, although the Report points out what needs to be determined, it does not assist the courts with the methods to use; therefore, the Report does not assist the courts. However, courts have decided on many occasions that spouses involved in economic activities are eligible for the Chapter 13 business rescue regime in a joint case.[289]

2.2.2.4 Summary

Unlike in South Africa, in the United States there is a single statute that regulates insolvency and business reorganisations proceedings, namely the *Bankruptcy Code 1978*. Three chapters in this Code facilitate business rescue for sole traders, partnerships and corporations. Three important lessons can be derived from the *Bankruptcy Code*. First, Chapter 11 encompasses all debtors. It means that anyone involved in economic activities either as a sole trader, partner or corporation is eligible for business reorganisations. Second, partnerships, whether ordinary or limited liability partnerships (LLPs) are treated as legal entities for purposes of business reorganisation. Third, debtors can be classified in terms of the industry in which they operate their business. Chapter 12 is dedicated to farmers. Any debtor who is a farmer is allowed to apply for business reorganisation under Chapter 12. Fourth, natural persons involved in economic activities may apply for relief under Chapter 13. Chapter 13 provides a simple, easy and cheap reorganisation scheme for sole proprietorships. The UK took a different approach in 1986. Instead of dividing the insolvency legislation into chapters as in the *Bankruptcy Code*, the parliament promulgated unified

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286 House Report 1897:320. The report provides that whether a small business operated by a husband and wife, the so-called "Mom and Pop grocery store", will be a partnership and thus excluded from Chapter 13, or a business owned by an individual will have to be determined on the facts of each case.

287 Kennedy 1979:992-993; Tayman 2020:81-95.

288 Drake & Morris 1983:211; Kennedy 1979:993; Tayman 2020:81-95.

289 *In re Estalella*, 101 B.R. 391 (Bankr. S.D. Fla. 1989). *In re Pantelis Melachrinoudis*, 63 B.R. 698, 14 Bankr. Ct. Dec. (CRR) 913, Bankr. L. Rep. (CCH) P 71404 (Bankr. E.D. Pa. 1986).

legislation but separated provisions that apply to companies from provisions that apply to natural persons.

2.2.3 UNITED KINGDOM

The development of the law of insolvency in the UK shows that personal and corporate rescue regimes can be regarded as two separate areas of law.[290] Before 1986, the law of insolvency was described by scholars as being in a state of crisis.[291] The main problem was that creditors, in their desire to secure returns from failing companies, were outclassing each other by creating artificial security clauses in credit agreements. Financial institutions such as banks exploited floating charges and later introduced fixed charges over future assets, [292] while unsecured creditors retaliated by using title retention clauses and trust devices. To make matters worse, the legislature's attempt to prevent the abuse of floating charges by companies on the verge of insolvency was ineffective and neutralised by the courts.[293] Ideas such as corporate rescue or debt relief were only known as out-of-court proceedings.

Different committees were established to review the law of insolvency but none of them provided sustainable solutions except the Cork Committee.[294] The Committee chaired by Sir Cork was commissioned to review and reform the law relating to insolvency, receivership and liquidations. Furthermore, they were required to examine the feasibility of a unified insolvency system and suggest possible alternatives to personal bankruptcy and company winding up.[295] It resulted in the compilation of the Cork Report of 1982. The Cork Report recommended that the insolvency of natural persons and companies should be dealt with in a single statute.[296] In this regard, the

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290 Fletcher 2009:12; see also Finch 2002:7; Mokal & Armour 2004:117-118; Skelton & Turner 2008:8-10; Walters 2005:65-104.

291 Goode 1980:123; Milman 1987:61-65.

292 Automatic crystallisation was accepted in *Re Manurewa Transport Ltd* [1971] NZLR 909; and *Stein v Saywell* (1969) 121 CLR 529; see also *Re Caroma Enterprises Ltd* (1980) 108 DLR 412; the *Manila Railways Case* [1897] AC 81, *R v Churchill Consolidated Copper Corp* (1979) 90 DLR (3d) 357, *Re Caroma Enterprises Ltd* (1980) 108 DLR 412; see also Williams 2016:18-19.

293 Milman & Hare 1980:110-111.

294 Committees appointed to review bankruptcy law included the Muir Mackenzie's Committee (1906, Cd 4068); the Hansel Committee, Cmnd 2326 (1925; and the Blagden Committee, Cmnd 221 (1957); The Insolvency Law and Practice: Report of the Review Committee, Chairperson Sir Cork CBE (Cmnd 8558 (1982)), hereinafter referred to as the Cork Report, is the only committee that provided reforms culminating in the promulgation of the *Insolvency Act* of 1986 came into force on 29 December 1986.

295 The Cork Committee was appointed on 27 January 1977 by Mr Edmund Dell (MP). The term is used to refer to a combination of rescue processes enacted into law as a separate legislation.

296 Cork Report 1982:446.

Cork Report stated that there is a need to introduce a "simplified and uniform procedure enabling creditors to initiate insolvency proceedings against any kind of debtor, individual or corporate".[297] More importantly, the Report emphasised that it is necessary:

> to encourage wherever possible, the continuation and disposal of debtor's business as a going concern and the preservation of jobs for some of the employees, and to remove obstacles which tend to prevent this.[298]

These recommendations led to the promulgation of the *Insolvency Act* of 1986 (IA 1986). This Act now regulates the law of insolvency and business rescue.[299] The IA 1986 is a consolidation of provisions from the IA 1983 and the *Companies Act* of 1985, only the part that deals with corporate insolvency.[300] The most significant innovation introduced by the IA 1986 is corporate rescue and alternatives to bankruptcy. The following parts focus on alternatives to bankruptcy that apply to sole proprietorships and certain provisions of corporate insolvency that apply to partnerships.

2.2.3.1 Insolvency Act of 1986

The IA 1986 is divided into three parts. The first part oversees issues on corporate insolvency and winding up, and the second deals with natural persons, whether consumer or self-employed. The third part provides general provisions applicable to both companies and natural persons, such as the appointment and removal of insolvency practitioners. Similar to the South Africa regime, debtors in the UK are classified by their legal status and not their economic activities.[301] It means that a debtor's eligibility strongly depends on whether the debtor is a company or a natural person.[302] The IA 1986 provides for two main regimes: the first one applies to companies and LLPs, and the second regime applies to all natural persons regardless

297 Cork Report 1982:446 at 1(d).

298 Cork Report 1982:446 at 2.

299 The *Insolvency Act* of 1986 came into force on 29 December 1986.

300 This gave effect to the recommendations of the Cork Report regulating both natural and corporate persons with the same statute; see also Fletcher 2009:22; Levenstein 2016:104; Loubser 2010:16.

301 Loubser 2007:455.

302 Belcher 1997:12.

of whether they are consumer debtors or business debtors.[303] In 2002, the parliament approved amendments to the IA 1986.

2.2.3.2 Enterprise Act of 2002

The *Enterprise Act* of 2002 (EA 2002) brought about significant changes to the IA 1986 and the addition of the individual voluntary arrangement (IVA) to the already existing debt relief order (DRO) scheme.[304] These two schemes apply to ordinary debtors, selfemployed individuals and partners in a partnership. This study examined these two regimes to establish their suitability to owners of sole proprietorships and partners in a partnership in South Africa. The following short paragraphs explain the requirements that must be met by an individual to qualify for IVAs or DROs.

Individual voluntary arrangement

An individual, whether self-employed or a partner in a partnership may apply for an IVA.[305] An IVA is an agreement between the debtor and creditors wherein the debtor undertakes to pay all or in part of its debts.[306] The payments are paid to an insolvency practitioner, who in turn divides the money between the creditors.[307] To qualify for an IVA, the creditors must have accepted the debtor's proposal. An IVA is only acceptable if the creditors holding 75 per cent of the debtor's debts, agree to a proposed IVA.[308]

Debt relief orders

A DRO is an alternative to an IVA. It creates a moratorium that prohibits creditors on its list from suing the debtor in respect of debts stated in the order. To be eligible for a DRO, the sole trader must be domiciled in England or Wales or should have been carrying on the business for three years in England or Wales.[309] If debtors are in an undischarged bankruptcy[310] or are subject to a bankruptcy restriction order or a debt

303 Greenberg 2020:1-5.

304 *Enterprise Act* 2002 Chapter 40.

305 *Insolvency Act* 1986: Part 8; see also Tonge 2006: 53; Davy 1991:11-12; Möser 2019:240-270. Grenville 1989:104-108. Part VIII of the Act applies to a partner or partners where insolvency orders are made against the partnership and that partner or partners.

306 *Holl and Another v Van Der Heiden* [2010] EWHC 537 (TCC).

307 Greenberg 2020: par. 1-10.

308 Insolvency Rules 1986: rule 532(4); *Gertner v CFL Finance Ltd* [2018] EWCA Civ 26.

309 *Insolvency Act* 1986: Sch 4ZA par. 1.

310 *Insolvency Act* 1986: Sch 4ZA par. 2(a).

relief restriction order, they do not qualify for a DRO.[311] The value of the debtor's assets must not exceed 1 000 pounds.[312] When calculating the value of the debtor's assets, assets that fall within the Insolvency Proceedings Rule, including basic household items, tools of the trade, and a domestic vehicle, are excluded from the calculation. [313]The debtors must show that they are unable to pay and the debt in question is a qualifying debt.[314]

A qualifying debt in this instance means "any debt for a liquidated sum payable immediately or at some certain future time".[315] The total amount of the qualifying debts cannot exceed 20 000 pounds. The eligibility criterion for DROs is strict and may not promote entrepreneurship. Sole traders with assets exceeding 1 000 pounds, or whose qualifying debts are over 20 000 pounds, are automatically disqualified from applying for DROs.

2.2.3.3 Insolvent Partnership Order of 1994

A partnership on the verge of insolvency is eligible for partnership voluntary arrangement (PVA) or partnership administration order in terms of the IPO 1994.[316] The provisions for voluntary arrangements in sections 1 to 7B of IA 1986 were modified to accommodate insolvent partnerships in Part 1 of IPO 1994.[317] Hence, the IPO 1994 was promulgated to provide a business rescue scheme for partnerships. In the UK, insolvent partnerships are essentially treated as unregistered companies;[318] however, it is not clear whether an insolvent partnership is regarded as a legal entity. Section 9 of the Partnership Act (PA) 1890 provides that "every partner in a firm is liable jointly with the other partners … for all debts and obligations of the firm".[319] It implies that although an insolvent partnership can conclude a voluntary arrangement or apply for

311 *Insolvency Act* 1986: Sch 4ZA par. 2(c).

312 *Insolvency Act* 1986: Sch 4ZA par. 8(1).

313 Insolvency Proceedings (Money Limits) Oder 1986: par. 8.

314 *Insolvency Act* 1986:sec. 251(A) (1); see also government's explanatory notes to that Act: Only individuals who are unable to pay their debts may apply for a DRO. This section also identifies the debts to which a DRO may apply, which are called *qualifying debts* in the Act. The debts must be for an identifiable amount of money and must not be secured or within any description of debt that may be prescribed by order as being excluded from being a qualifying debt.

315 *Insolvency Act* 1986:sec. 251(a)(2)(a).

316 *Insolvent Partnership Order* 1994/2421: art. 4. Berry & Parry 2015:1-23.

317 *Insolvent Partnership Order* 1994: Part 1.

318 Berry & Parry 2015:1-23; Frieze 1995:34.

319 *Partnership Act* 1980:sec. 9; *Hawkes v Cuddy* [2009] EWCA Civ: 291.

administration, creditors can still sue individual partners for partnership debts. Hence, it is advised that when an insolvent partnership concludes a PVA or applies for a Partnership administration order, individual partners should also apply for IVAs as prescribed in article 5.[320] The following sections discuss partnerships as debtors and aim to determine whether partnerships in the UK are considered legal persons or as an association of individuals for purposes of insolvency.

General partnership as debtor

A general partnership is also known as a firm. General partnerships are formed and regulated in terms of the PA 1980 (c. 39). In terms of section 4(1), persons who have agreed to form a partnership to conduct a business are collectively called a firm.[321] However, in Scotland, a firm is "a legal person distinct from the partners of whom it is composed, but an individual partner may be charged on a decree or diligence directed against the firm, and on payment of the debts is entitled to relief pro ratâ from the firm and its other members".[322] This type of partnership is formed to carry on business to make a profit.[323] Its key features are that all partners participate in the management of the business;[324] profits are shared in proportion to each partner's contribution, and each partner is competent to act as an agent of the partnership.[325] The partners are jointly liable for the debts of the partnership. During insolvency proceedings, an ordinary partnership is regarded as an association of persons.

Limited partnership as debtor

The *Limited Partnership Act* of 1907 (LPA 1907) introduced the concept of a limited partnership.[326] A limited partnership consists of one or more general partners and one

320 *Insolvent Partnership Order* 1994:art. 5: "Where insolvency orders are made against an insolvent partnership and an insolvent member of that partnership in his capacity as such, Part I of the Act shall apply to corporate members and Part VIII to individual members of that partnership, with the modification that any reference to the creditors of the company or of the debtor, as the case may be, includes a reference to the creditors of the partnership."

321 *Partnership Act* 1980:sec. 4(1).

322 *Partnership Act* 1980:sec. 4(2); *Duncan v The MFV Marigold* PD 145: par. [14].

323 *Partnership Act* 1980:sec. 1: "Partnership is the relation which subsists between persons carrying on a business in common with a view of profit"; *Barber v Rasco International Ltd* [2012] EWHC 269 (QB); *Philips v Symes [2002] 1 WLR 853*: par. 43.

324 *Partnership Act* 1980:sec: 9.

325 *Kotak v Kotak* [2017] EWHC 1821.

326 *Limited Partnerships Act* 1907(c24):sec. 4.

or more limited partners.[327] Limited partners are not liable for the debts or obligations of the firm beyond the amount they contributed.[328] However, all general partners are liable for the debts and liabilities of the firm.[329] The main difference between general and limited partnerships is that a limited partnership is composed of general and limited partners. It entails that a limited partnership is not a legal entity and that limited liability applies to limited partners. Thus, an LLP is also regarded as an association of persons during insolvency proceedings. However, limited liability partners remain insulated from the debts and liabilities of the partnership.

Limited liability partnership as debtor

A partnership is formed in terms of the *Limited Liability Partnership Act* of 2000 (c. 12), (LLPA). According to the LLPA , a partnership is a body corporate with a legal personality separate from its members.[330] As such, the insolvency of LLPs is regulated in terms of the same provisions meant for companies. The governing legislation are IA 1986, as amended by EA 2002 and the *Companies Directors Disqualification Act* of 1986. This means that LLPs can propose a voluntary arrangement, or apply for an administration order or go into receivership. Initially, these rescue procedures were only applicable to companies.[331]

The move to treat LLPs the same way as companies, received negative reviews from commentators and practitioners. Fletcher described the rescue procedure provided by IA 1986 as cumbersome and expensive, mainly because it relies on the courts.[332] The other reason is that there is no provision for a moratorium preventing affected persons such as creditors from enforcing their claims against the LLP, while the rescue plan is still under consideration. Thus, voluntary arrangements and administration have to be initiated simultaneously. It inevitably increases the cost of the rescue.[333] Grier and

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327 *Limited Partnership* Act 1907: sec. 4(2);

328 *Limited Partnership Act* 1907: sec. 4(2A);

329 *Limited Partnership Act* 1907:sec. 4(2).

330 Henning 2014(a):165,196; Milman 2001:178-179; The explanatory notes to the Act comment that the Act's main purpose is to create a new legal entity which will have "the organisational flexibility and tax status of a partnership with limited liability for its members".

331 *Insolvent Partnership Order* 1994: par. 6(1).

332 Fletcher 2002:515.

333 See Sealy & Milman 2011: 980-985.

Floyd contended that the whole rescue procedure in the IA 1986 was not suitable for small to medium enterprises.[334]

Although LLPs are regarded as separate legal persons, the decision to treat them as companies for purposes of insolvency has proved to be challenging to implement. The problem lies in the overlap between the insolvency of individuals and the insolvency of the partnerships as an entity. The IPO 1994 is the only instrument that seeks to bridge the gap between provisions applicable to companies that may not apply to ordinary and limited partnerships.[335] The IPO 1994 customises provisions in the IA 1986 to meet the needs of an insolvent partnership on the verge of insolvency, or which is already insolvent.[336] The efficacy of this order is reviewed in the next chapter. I am of the view that the UK stands to provide an example of good practices when dealing with partnerships, especially when attempting to rescue them when in financial distress.

2.2.3.4 Summary

Several lessons can be drawn from the UK approach to sole traders and partnerships. The law of insolvency applicable to sole traders and partnerships in the UK is regulated in terms of Chapter 45 of IA 1986. This Act offers two different alternatives to bankruptcy regimes for sole traders and partnership: Sole traders are treated the same way as natural persons not involved in economic activities. However, the current debt relief schemes provide sustainable avenues for sole traders to avoid bankruptcy. The classification of debtors for sole traders is based on the debtor's behaviour, amount of debt and the value of the debtor's assets. The debt or value of assets threshold is useful when dealing with amateur entrepreneurs whose businesses have failed. This study suggests that business rescue should be restricted to debtors with enough assets to attract post-commencement finance. The debt or asset threshold criterion can be used for UBEs to sift viable from failing businesses.[337] "Start-up" businesses are prone to fail, but the business rescue regime should be restricted to viable enterprises.[338]

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334 Grier & Floyd 1995:6.

335 *Insolvent Partnership Order* 1994 (SI 1994/2421.

336 *Official Receiver v Hollens* [2007] EWHC 754 (Ch), [2007] B.P.I.R: 830.

337 See further discussion on 2.3.1.

338 See further discussion on 2.3.1

In South Africa, the formation of a partnership is facilitated by agreement, but in the UK, the formation of a partnership, whether ordinary or LLP, is regulated in terms of specific legislation. General and limited partnerships are treated as unregistered companies for purposes of bankruptcy and they are eligible to apply for voluntary arrangement or administration or a partnership. Although an insolvent partnership is allowed to apply for debt relief, the legislature had to modify the provisions applicable to companies to suit the needs of partnerships. The legislation experience with partnerships in the UK demonstrates that a business rescue scheme for partnerships should be separated from the rescue scheme that applies to companies. Deriving lessons from the UK and other countries, Kenya recently promulgated unified legislation that provides a variety of business rescue procedures and debt relief schemes. The next section explores Kenya's attitude towards UBEs, with particular focus on alternatives to bankruptcy.

2.2.4 Republic of Kenya

The law of insolvency in Kenya was regulated in terms of the now-repealed *Bankruptcy Act*, CAP. 53, promulgated in 1983. The *Bankruptcy Act* 1983 was inherited from the British colonial parliament and for decades defined the rules governing the insolvency of natural and juristic persons.[339] Scholars have described the repealed Act as moribund, archaic and no longer conforming to local and international standards.[340] It has also been difficult for the courts to apply the Act with the same spirit and purpose as intended by the then British Parliament.

Himbara argued that the business environment in Kenya has failed to Africanise commerce and industry.[341] For the past decades, entrepreneurship, innovation and investment have remained stagnant mainly because there are no laws that promote

339 Wabwile 2003:51-58; see also Masoud 2013:195-207; Nyabira, Muigai J & Murangi : 2021: 1-2.

340 Murungi 2014:1; see also Too 2015:3. Masoud 2013:97 stated that "[t]he law relating to insolvency which is operative in Kenya has remained in force without any substantive reform for about five decades. The changing economic climate coupled with the drive by multilateral institutions for institutionalisation of the rule of law and good governance in developing countries have created a pressing need for amelioration of insolvency law and cross-border insolvency law in Kenya."

341 Himbara 1994:469 argued that the "Government efforts to aid African entrepreneurs, or to establish a vigorous state capitalist sector, have been ineffective. This is evident from surveys of the state enterprise sector, private manufacturing and commerce. Revisionist authors tended to overestimate the capacity of Kenyan state agencies to implement policy goals, and they neglected the political context of Africanization as an instrument of ethnic patronage for state leaders."

corporate rescue or a fresh start for entrepreneurs.[342] This led the Kenya Law Reform Commission to moot for the promulgation of insolvency legislation to solve problems faced by business owners, bankers, and investors.[343] As a result, the legislature enacted the *Insolvency Act* of 2015 (IA 2015) based on best practices from the UK, New Zealand and Canada. In *In re Nakumat Holdings Limited*,[344] Onguto J held that although the newly enacted Act was substantially derived from foreign law, its interpretation should not lose sight of Kenya's unique socio-economic character.[345] Kenya's new insolvency legislation clearly demonstrates the need to replace the old colonial legislation with new innovative laws that embrace modern ideologies such as business rescue or debt relief.

2.2.4.1 New Insolvency Act of 2015

The IA 2015 unifies the insolvency of natural persons, partnerships and companies. In *re Winding up of Karuturi Limited* Eklr,[346] J Ochieng commented:

> The purpose and intent of the new law was to provide alternative procedures to both bankruptcy of insolvent natural persons, and the liquidation of incorporated and unincorporated bodies, to enable the affairs of such persons or bodies to be administered for the benefit of their creditors.[347]

From this brief description of the legislature's intention, it is clear that IA 2015 was meant to provide bankruptcy proceedings for all debtors and alternatives to bankruptcy. The phrase "alternatives to bankruptcy" refers to business rescue regimes and debt relief schemes. The IA 2015 provides a variety of alternatives to bankruptcy, and for this reason, I believe South Africa may learn new approaches to insolvency.

The IA 2015 applies to all forms of debtors regardless of their legal form or economic activities. This entails that natural persons and legal persons are eligible to apply for bankruptcy or alternatives to bankruptcy. I am concerned with business rescue procedures applicable to UBEs, specifically, sole proprietorships and partnerships. In the following section, I will define the term *debtor* for purposes of bankruptcy in terms of IA 2015.

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342 Mutuku 2010:8; see also Gachenge & Ngugi 2013:561-563; Mwega & Ngugi 2005:119.

343 Kiamu 2010:1 see also Gachenge & Ngugi 2013:561-563; Kimani 2010:1.

344 *In re Nakumat Holdings Limited* [2017] eKLR Insolvency Cause 10 & 13 of 2017**:**36-37.

345 *In re Nakumat Holdings Limited* 2017:37.

346 *In re Winding up of Karuturi Limited* [2016] Eklr: 6-7.

347 *In re Winding up of Karuturi Limited* [2016]: par. 7.

2.2.4.2 Defining the term *debtor*

The opening section of the IA 2015, after the long title in section 1, provides a list of definitions, including the term *debtor*. According to section 2 of the Act, a debtor is a person who owes a debt. In the same section, a person is defined as including "a partnership, an unincorporated association, a corporation, a cooperative society or an organization, the successors of a partnership, association, corporation, society or organization, and heirs, executors, liquidators of the succession, administrators or other legal representatives of a person."[348] I am of the view that section 1 is meant to provide a general understanding of the term *debtors*. Hence, in the following sections, I attempt to provide a clear view of what this term means in relation to UBEs.

Sole proprietorship

The term *sole proprietorship* is not used in the IA 2015, but a debtor is defined as including a natural person.[349] It means that a natural person is eligible for bankruptcy proceedings[350] and alternatives to bankruptcy proceedings.[351] In terms of section 15(3) of IA 2015, a debtor is eligible to apply for bankruptcy proceedings only if the debtor resides or has been carrying on business in Kenya for three years.[352] Furthermore, section 2 provides that *business* includes trade and profession.[353] It implies that although the IA 2015 does not explicitly identify sole traders as debtors, natural persons involved in economic activities are eligible to apply for alternatives to bankruptcy.

Ordinary partnerships

In terms of section 2 of the IA 2015, a "person" includes a partnership. In the same section, *partnership* is defined within the meaning of the *Partnership Act* (PA) of 2012. According to the PA 2012, a partnership is a statutory relationship wherein the partners are jointly and severally liable for the debts and liabilities of the partnership.[354] In other words, a partnership formed in terms of the PA 2012 is not a juristic person. Although

348 *Insolvency Act* 2015:sec. 2.
349 *Insolvency Act* 2015:sec. 12.
350 *Insolvency Act* 2015:sec. 15.
351 *Insolvency Act* 2015:sec. 14.
352 *Insolvency Act* 2015:sec. 15(3)(a) and (c).
353 *Insolvency Act* 2015:sec. 2.
354 *Partnership Act* [16] 2012:sec. 11.

a partnership is not a juristic person, the partnership is liable for loss, injury or penalty incurred during the ordinary course of the business of the firm. Section 14 of the PA 2012 provides that when a wrong has been committed by a partner acting in the ordinary course of business of the firm, the partnership is liable to satisfy such debt or liability.[355] Thus, section 14 contemplates the recognition of an ordinary partnership as a separate entity only for purposes of apportioning liability that arises during the course of business.

Does section 14 of the PA 2012 apply under IA 2015?

IA 2015 states that a "debtor" means "a natural person who owes money to one or more creditors; and, if a … partnership …, all of the partners of the partnership". This implies that an ordinary partnership is treated as an association of persons for purposes of insolvency proceedings. The consequence of this approach is that a partnership is not eligible to apply for alternatives to bankruptcy under IA 2015, but all partners in the partnership qualify as joint debtors.

I foresee complications arising from this approach. First, the IA 2015 only provides for joint applications for bankruptcy proceedings and not for alternatives to bankruptcy. In other words, partners cannot make a joint application for debt relief schemes in terms of Part VI. Second, if the partners are allowed to apply for debt relief, the IA 2015 does not clarify the implications of the order on the personal creditors of the partners and the partnership creditors. Generally, treating a partnership as an association of the individual for purposes of insolvency or business rescue is difficult and complicated. The same approach was adopted in the UK, but the legislature decided to promulgate a separate insolvency regime for partnerships. The efficacy of the Kenyan approach is yet to be tested.

Limited liability partnership

A company in financial distress may opt for administration[356] or voluntary arrangements.[357] As previously stated, the term *company* includes registered

[355] *Partnership Act* 2012:sec. 14.
[356] *Insolvency Act* 2015:sec. 520.
[357] *Insolvency Act* 2015:sec. 624.

companies in terms of the CA 2015 and also includes an LLP.[358] Does this suggest that an LLP is an association of persons or a legal entity?

The LLPA provides that an LLP is a separate legal entity with perpetual existence.[359] A change in the partners does not affect the existence of the partnership, including its rights and obligations.[360] More so, partners are not personally liable for the debts of the partnership.[361] When an LLP is on the verge of insolvency, it can apply for administration in terms of section 520.[362] The debtor may appoint an administrator who will assess the financial situation of the partnership. After that, the administrator makes a proposal to the creditors, either placing the debtor under administration or liquidation.[363] The administrator's first mandate is to assess the position of the debtor. In terms of Regulation 2016, the administrator must include the debtor's financial account and a brief description of the circumstances giving rise to the appointment of an administrator.[364] Permitting an administrator to evaluate the debtor's financial circumstances is prudent before deciding to rescue or liquidate the debtor, is prudent. It allows creditors to assess their situation before they vote for administration or liquidation. The administrator's recommendations reflect the debtor's creditworthiness and capacity to acquire future debts.

The following section briefly describes the different alternatives to bankruptcy procedures available to natural persons and ordinary partnerships. At this stage, I explore the requirements for a debtor to be eligible to file a petition for relief.

2.2.4.3 Alternatives to bankruptcy

As previously mentioned, alternatives to bankruptcy are different business rescue procedures and debt relief schemes aimed at avoiding bankruptcy proceedings. Thus, the phrase "alternatives to bankruptcy" describes a combination of rescue schemes that may be used by ordinary debtors and debtors involved in economic activities such as self-employed debtors or partners in a partnership. Four alternatives to bankruptcy are provided in IA 2015: IVAs, expedient procedure, summary instalments, and no-

358 *Insolvency Act* 2015:sec. 2.
359 *Limited Liability Partnership Act* [30A] 2012:sec. 6.
360 *Limited Liability Partnership Act* 2012:sec. 6.
361 *Limited Liability Partnership Act* 2012:sec. 10.
362 *Insolvency Act* 2015:sec. 520.
363 *Insolvency Act* 2015:sec. 566.
364 *Insolvency Act Regulation* 2016:sec. 110.

asset procedures. The following subsections discuss each procedure and its requirements for eligibility.

Individual voluntary arrangements

An IVA allows the debtor to make a payment arrangement with its creditors. A natural person involved in economic activities such as a sole trader is eligible to apply for an IVA. In *re Joyce Wanjiku*,[365] the High Court in Nairobi demonstrated that sole proprietorships are eligible to apply for IVAs. In that case, Joyce Wanjiku operated a sole proprietorship in selling and delivering sand for construction in Kenya. As part of that business, Wanjiku bought several trucks through asset financing from three lending institutions: I & M Bank, NIC Bank, and CFC Stanbic Bank. However, due to family tragedy and the volatile business environment, Wanjiku defaulted.

Consequently, she scaled down operations and applied for debt relief in terms of Part IV of the IA 2015. The application was made by Wanjiku as a natural person involved in economic activities. She prayed for the recognition of her business and an interim order that would allow her to restructure the loan agreement. The court was silent on the legal status of Wanjiku's business but ruled that she qualified for debt relief as contemplated by the IA 2015.[366] It meant that Wanjiku could enter into a voluntary arrangement with her business creditors. The court further ruled that all actions and legal proceedings against the debtor remained.[367] However, the court did not provide the scope of the moratorium. Hence, the judgement had the effect of prohibiting both personal and business creditors from instituting legal proceedings against Wanjiku. It is not clear whether the court foresaw this consequence. The different implications arising from this case as a precedent for sole proprietorships in Kenya are described in Chapter 3.

Expedient procedure

An expedient procedure is available to a debtor who intends to propose a voluntary arrangement to creditors. There are three requirements for the expedient procedure: First, the debtor must be in an undischarged bankruptcy;[368] second, the official

365 *In re Joyce Wanjiku* [2020] eKLR: par. 6, 7 and 8.
366 *In re Joyce Wanjiku* [2020] eKLR: par. 5.
367 *In re Joyce Wanjiku* [2020] eKLR: par. 6.
368 *Insolvency Act* 2015:sec. 316(1)(a).

receiver must have been identified as the provisional supervisor of the proposal;[369] and third, the debtor must not have applied for an interim order.[370]

Summary instalment order

A summary instalment order is an order made by the official receiver directing the debtor to pay the debtor's debt in instalments.[371] Any debtor or creditor may apply to the official receiver for an instalment order. However, if the applicant is the creditor, such creditor requires the consent of the debtor.[372]

No-asset procedure

The no-asset procedure is available to debtors without realisable assets. In terms of section 344 of the IA 2015, a debtor who meets the requirements stipulated in section 345 may apply to the official receiver for admission to the no-asset procedure. Section 345 states that the official receiver may admit a debtor to the no-asset procedure if it is shown on good cause that the debtor has no realisable assets, has never been admitted to the no-asset procedure and has not previously been declared bankrupt.[373] More importantly, the debtor must have a total amount of debts not less than four million shillings and the debtor must not have any means to repay its creditors.[374]

2.2.4.4 Summary

Since the South African company law is derived from England and Kenya following its footsteps, it was necessary to consider unified legislation that provides relief for all debtors, regardless of their legal form or structure. Kenya provides a recently unified legislation that has successfully provided for the rescue of sole traders, partnerships and companies. A sole trader is not treated as a legal entity. However, a person involved in economic activities is allowed to apply for debt relief for the business. The application does not affect the debtor's personal affairs. Ordinary and limited partnerships are not treated as legal persons. Rather all partners are treated as debtors for purposes of applying for debt relief. Thus, partnerships can apply for debt relief but the partners must jointly apply for relief. Limited liability partnerships are

369 *Insolvency Act* 2015:sec. 316(1)(b).
370 *Insolvency Act* 2015:sec. 316(1)(c).
371 *Insolvency Act* 2015:sec. 323.
372 *Insolvency Act* 2015:sec. 324.
373 *Insolvency Act* 2015:sec. 345(a)-(c).
374 *Insolvency Act* 2015:sec. 345(d) and (e).

treated as companies. This means that they are legal persons. It also follows that when an LLP is in financial distress, it is eligible to apply for administration or voluntary arrangements.

2.3 CRITICAL ANALYSIS OF THE ELIGIBILITY CRITERIA

Since South Africa is lagging behind other countries regionally and internationally, it is clear that there is a need to enact a business rescue regime that is specifically designed to meet the needs of UBEs. The regime should be founded on an eligibility criterion that meets international standards. The discussion above revealed four important principles in the classification of debtors: the debtor's commercial activities, creditworthiness, commercial morality, and legal personality. This section expands on these four concepts in detail.

2.3.1 Commercial activities of natural persons involved in business

The World Bank Insolvency and Creditor/Debtor Rights Standards state that there are two types of debtors: the business and consumer debtor.[375] Business debtors acquire debt when carrying out business, whereas consumer debtors acquire debt through the acquisition of goods and services for consumption.[376] Therefore, a consumer debtor can be understood as a natural person who concludes a credit agreement for purposes outside his trade, business or profession.[377] On the contrary, a business debtor incurs debts during business activities. This differentiation is easy to apply when dealing with companies and natural persons; however, the difficulty arises where a debtor is a natural person involved in commercial activities, either as a sole proprietor or in partnership with another natural person.[378] There are many policies applicable to natural persons. However, most of these regimes are not relevant to the needs of persons involved in economic activities.

The Legislative Guide recommends that different tests be developed to determine the eligibility of natural debtors involved in economic activities for any procedure to meet these gaps. The test may include the "nature of the debtor's activity, the level of debt

375 World Bank 2011:5.
376 World Bank Group 2017a:13; Loubser 2007b: 444-461.
377 World Bank Group 2017a:13.
378 World Bank Group 2017a:15.

and the connection between the debt and the economic activity",[379] while indicators of involvement in commercial or economic activities may include: whether the debtor registered its business; whether the debtor operates its business as a sole trader or partnership; whether the debtor operates its business regularly; or evaluating the value of the debtor's assets and liabilities.[380] I believe four factors should be assessed to draw a meaningful distinction between natural persons involved in economic activities and consumer debtors, namely the nature of the business, permanent engagement in commercial activities, capacity to employ[381] and value of assets and liabilities of the debtor. The following sections explain how each factor should be considered.

2.3.1.1 Nature of the business

The World Bank Group states that debtors in economic activities are traditionally classified as wage-earning debtors.[382] However, the transformation of the labour market has transformed many providers of low-skill services from employees into self-employed service providers during the past decades.[383] In developed economies, sole traders are recognised as employers.[384] Business ventures such as farming, artisans, craftsmen, and professionals, including lawyers, doctors, and accountants, have been noted as requiring a separate insolvency system.[385] The World Bank Group shows an emerging trend in developed economies of providing separate business rescue procedures for natural persons involved in economic activities.[386] I am concerned with UBEs offering goods and services that form part of a growing economy. These may include goods such as minerals, electricity, agricultural products and professional services such as lawyers and doctors.

The Small Enterprises Development Agency (SEDA) report states that the number of SMMEs has grown by 4.4 per cent against a backdrop where economy-wide

379 UNCITRAL 2005:39 par. 4.
380 UNCITRAL 2005:39 par. 4.
381 INSOL International 2001:19-20.
382 World Bank Group 2017:5.
383 World Bank Group 2017:15; Chapter 13 of the Bankruptcy Code in the USA is a good example.
384 In the USA the Congress passed *The Small Business Reorganisation Act* of 2019, which was scheduled to come into effect in February 2019. *Armenia*, under the Law on Bankruptcy (enacted in 2006, as amended in 2016).
385 World Bank Group 2017:19.
386 World Bank Group 2017:15

employment has contracted by 0.4 per cent.[387] Statistics on small and medium enterprises suggest that most natural persons involved in economic activities specialise in manufacturing, transport, and agriculture.[388] These industries are considered essential for the economic growth of the country.

It is suggested that for a debtor to be eligible for business rescue, it must demonstrate that the nature of its business is such that it is scalable or sustainable. Scalability in this sense, means that the business has the capacity to grow without being hampered by its structure or available resources when faced with increased production. If this requirement cannot be met, the debtor must demonstrate that its services or business is sustainable. This can be proved by showing that the skills necessary for such a service are currently recognised as critical skills in South Africa.

2.3.1.2 Permanent engagement in commercial activities

A natural person involved in economic activities may be regarded as an entrepreneur. There are two kinds of entrepreneurs, namely permanent and part-time entrepreneurs. Part-time are natural persons who start business ventures because of financial and economic difficulties but have no intention of remaining in business.[389] When a temporal entrepreneur finds formal employment, they are likely to abandon the venture or employ another person to run the business. In contrast, permanent entrepreneurs are those entrepreneurs who are fully committed to the business. They may be regarded as permanent employees of the business.[390] The proposed business rescue in this study is concerned with permanent or full-time entrepreneurs. On that note, it is proposed that for a debtor to be eligible for business rescue, the debtor must demonstrate that he or she is committed to the business. The legislature should determine how an applicant can demonstrate his or her commitment to the business. There are two reasons for excluding part-time entrepreneurs and SMEs that are established to operate for a specific period, like a special purpose vehicle. First, when a part-time entrepreneur receives an offer for a permanent job, they abandon the business. Loubser argues that most entrepreneurs start businesses to survive and

387 SEDA Report 2019:12.

388 SEDA Report 3rd Quarterly 2019: 22 and 27.

389 Global Entrepreneurship Monitor 2018/19:30-32.

390 Global Entrepreneurship Monitor 2018/19:30.

after securing permanent employment, they are no longer interested in pursuing business.[391] It becomes difficult to classify the business whether the owner is a consumer or a business debtor. Second, the business rescue process is meant to guarantee the continuation of the business. Therefore, if the business only serves the interests of the owner and creditors, rescue proceedings may be replaced by out-of-court procedures.[392]

2.3.1.3 Capacity to employ

Entrepreneurs who are committed to their business tend to create jobs.[393] This is one of the motivations for considering unincorporated debtors for business rescue. An entrepreneur who employs or can employ several employees should be considered a business debtor. The idea behind business rescue is that many jobs are also preserved by saving the business.[394] Therefore, it is reasonable to require a business rescue applicant to prove that if an order for business rescue were to be granted, it would preserve many jobs. Job creation is a key instrument for achieving sustainable and inclusive growth needed to generate creditworthiness and investor confidence.[395] The debtor must have employees for the rescue procedure to be regarded as a success. The InSOL Report states that in cases where the business is identifiable with the natural person who remains responsible for the debts of the business, such debtor should be considered a consumer debtor.[396] However, in cases where the debtor's business has employees, such a situation may require different approaches that may be aimed at rehabilitating the business.[397] It is argued that UBEs that have the capacity to employ should be considered for business rescue.

Do unincorporated debtors have the capacity to employ?

The Global Entrepreneurship Monitor researched 50 countries by examining the growth patterns of early entrepreneurs with a special focus on their capacity to create

391 Loubser 2007b 444-461.

392 See Chapter 2.2.2.1 discussion on the exclusion of partnership estoppel.

393 Global Entrepreneurship Monitor 2018/19:30.

394 Nagel *et al* 2019:389; see also Cassim *et al* 2012:862; Jones 2018:9.

395 Global Entrepreneurship Monitor 2017/18:39.

396 InSOL Report 2011:19-20.

397 InSOL Report 2011:19-20.

employment in the first five years.[398] It was revealed that 44 per cent of entrepreneurs do not expect to create jobs, while 20 per cent expect to create six or more jobs.[399] The development patterns evinced by the research also showed that in an efficiency driven economy, there was a shift from non-job creating entrepreneurship towards the middle range of one to five jobs anticipated in the following five years.[400] On the one hand, it seems to suggest a move away from sole entrepreneurship towards small employer-based activity in developed countries such as England, Finland and Switzerland.[401] On the other hand, in innovation-driven economies such as South Africa, entrepreneurs anticipated creating six or more job opportunities for the first five years. It is interesting to note that in the first quarter of 2019, the SMME sector created up to ten million jobs, accounting for 66 per cent of all jobs in South Africa.[402] SMMEs created an estimate of 2.55 million jobs. These numbers indicate a massive shift in the labour market from large incorporations to small UBEs, implying that large companies culled jobs at a very high rate.[403] It proves that UBEs in South Africa, although small and managed by entrepreneurs, can employ a significant number of employees. For this reason, I believe that an entrepreneur who employs two or more employees should qualify for business rescue. A debtor who wishes to apply for business rescue must show that the business is capable of employing a large number of employees.

2.3.1.4 Value of assets and liabilities

Natural persons involved in economic activities may be categorised in terms of the value of their assets or liabilities.[404] The Minister of the relevant industry can determine a threshold. For instance, the NCA 2005 does not apply to a debtor whose annual turnover or assets exceed R1 million.[405] In determining the value of the debtor's assets or debtor's liabilities, two questions must be answered: *What constitutes the debtor's estate*? and W*hat are the liabilities of the business*?

398 Global Entrepreneurship Monitor 2017:18:39.
399 Global Entrepreneurship Monitor 2017/18:39.
400 Global Entrepreneurship Monitor 2017/18:39.
401 Global Entrepreneurship Monitor 2017/18:39.
402 SEDA 2019:13.
403 SEDA 2019:13.
404 USA, *Bankruptcy Code* Chapter 13:sec. 1304.
405 *National Credit Act* 2005:sec. 7.

To answer the first question – *what constitutes the debtor's estate?* – it is proposed that the debtor's estate should include the debtor's personal and business assets. The business assets refer to the assets used to advance the commercial activities of the debtor. A distinction must be drawn between the debtor's assets and the assets used to advance the debtor's business. The debtor's assets refer to the assets procured for consumption, whereas the assets belonging to the business are those purchased or hired for carrying out the business. I suggest that in determining whether an asset belongs to the business, it should be shown that the property was bought to advance the interest of the business from the onset. For instance, a vehicle may be bought to assist with delivery. Movable property may include the debtor's tool of trade, manufacturing machinery and vehicle. A debtor may purchase a building at an industrial site and a house to reside in. The two properties belong to the same debtor, yet their purposes differ. If a debtor possesses immovable property and that property was purchased for business, the property should form part of the debtor's business estate. In cases where the debtor used his personal property to secure a start-up loan, the property forms part of the business estate. With that being established, the value of the debtor's assets must meet the threshold determined by the Minister. Put differently, for a debtor to qualify for business rescue, its business assets must be evaluated in view of a determinable threshold.

The Legislative Guide states that "[t]he insolvency law should govern insolvency proceedings against all debtors that engage in economic activities, whether natural or legal persons".[406] This approach was accurately implemented in Chapter 11 in the United States; Chapter 13 is dedicated to natural persons involved in commercial activities as sole traders. In the UK and Kenya they have single unified legislation that deals with the insolvency and provides alternatives to bankruptcy suitable for sole traders and partnerships. I propose that in South Africa, debtors involved in economic activities such as sole traders or partnerships should be considered for business rescue if they are permanently involved in some form of business. The Minister may prescribe a threshold based on the business's annual return or value of assets or the number of jobs created by the business. Business rescue may also be restricted to commercial activities such as industrial activities, such as farming, construction and mining, or professional services, such as accountants, doctors and lawyers. Economic

406 UNCITRAL 2005:44 par. 8.

activities are not the only factor to be considered; the legislature must also determine whether creditworthiness is necessary to classify debtors for purposes of business rescue.

2.3.2 Creditworthiness

In the twenty-first century, the notion of creditworthiness has grown to become a strong currency for participants in commercial relations.[407] Creditworthiness may be understood as the ability of a debtor to meet financial obligations and the accrued interests without affecting the viability of the creditors.[408] Synonymous to this concept is the phrase *tried and true*, denoting something that has been tested in the past and found to be reliable and effective. From the creditor's perspective, it means that the debtor has borrowed before and has satisfied his obligations when they became due. Neethling noted that creditworthiness forms part of a debtor's personal immaterial property rights.[409] In fact, an unlawful impeachment of another person's creditworthiness may amount to an infringement of their constitutional rights, such as the right to pursue an occupation.[410] Creditworthiness is a debtor's priceless asset in personal and business affairs. In *Wolmarans v ABSA Bank Ltd & Another*[411] (hereafter, the *Wolmarans* case) the court observed that:

> By virtue of the applicant's [building contractor] occupation it is apparent that his creditworthiness is a vital asset in his day to day dealings and, furthermore, that his listing as a credit risk [by the credit bureau] will prejudicially affect him. Should the listing remain pending the outcome of the civil litigation in the magistrate's court it is readily foreseeable that he may well be refused or denied credit facilities by various suppliers and institutions not only in respect of his business activities but also in respect of his personal affairs.[412]

Credit facilities, financial institutes and natural persons who wish to enter into a credit agreement with a company or an individual, should consider whether such candidate is creditworthy. Feschijan stated that it is necessary to check a person's creditworthiness when establishing new relations or on special occasions, such as

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407 This part is based on my presentation made at an International Conference; Sixth Annual International Mercantile Law Conference (herein referred to as Mpofu 2019:49).

408 Feschijan 2008:273.

409 Neethling 2006:377; see also *Hawker v life Offices Association of South Africa and Another* 1987 (3) SA 777 (C).

410 *Wolmarans v ABSA Bank Ltd & Another* 2005 (6) SA 551 at 557F-H.

411 *Wolmarans v ABSA Bank Ltd & Another* 2005: 562E-F.

412 *Wolmarans v ABSA Bank Ltd & Another* 2005: 557F-H.

when deciding to increase the amount of the credit.[413] It is conceded that business rescue is one of the incidences where it is necessary to determine the debtor's creditworthiness. The effect of the business rescue moratorium is that creditors are restrained from instituting legal proceedings against the debtor.[414] Hence, requiring an unincorporated debtor to satisfy the creditworthiness requirement before commencing business rescue proceedings is crucial.[415]

The European Law Institute Recommendation 10.02 provides that "[the] (near) insolvent micro and small businesses [should] have access to orderly proceedings regardless of available assets to cover the costs of proceedings."[416] The legislature promulgated a no-asset procedure to accommodate debtors without realisable assets in Kenya. However, in Chapter 13 of the US Bankruptcy Code, the debtor must demonstrate that they have a source of income. If a debtor is an undischarged bankrupt in the UK, such debtor is not eligible for debt relief. Considering the current approach in South Africa, which emphasises creditworthiness, I recommend that although the debtor may not have enough assets to satisfy the cost of the rescue procedure, the debtor must provide evidence of creditworthiness to qualify for business rescue.

2.3.3 Commercial morality

The symbiotic relationship between the law and morals forms the foundation of legal principles, doctrines and policies.[417] I am of the opinion that commercial morality should form part of the eligibility criterion in the proposed business rescue procedure. Commercial morality refers to the trustworthiness or fraudulency of the debtor. Since a natural person operates a UBE, the moral aptitude of the debtor should be considered when setting up an eligibility criterion for business rescue. The debtor's deportment is a question of morals and ethics; the legislature's mandate is to regulate aspects of behaviour that may harm *bona fide* economic participants.

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413 Feschijan 2008:274; see also Mpofu 2019:49.

414 Mpofu 2017:87.

415 *Southern Palace Investment 265 Pty Ltd v Midnight Storm Investment 386* 2012 (2) SA 423 (WCC):25; *Helderberg Laboratories CC and others v Sola Technologies* 2008 (2) SA 627 (C): par. 16.

416 European Law Institute 2017: Recommendation 10.02.

417 Alistar 2019:358.

The relationship between the law and morality has been the subject of legal thinking since antiquity.[418] Micescu was of the view that "law is a kind of morality imposed, with the guarantee of securing the respect it owes".[419] Participants in a mercantile-based economy also require regulation of their conduct to the extent that it maintains business efficacy. A study of different business rescue legislation reflects that there is some form of punishment when the debtor is fraudulent or misleading.[420] Most of the legislation has some element of Defoe's principles. According to Defoe, to promulgate an efficient insolvency system, the behaviour of the debtor is an effective tool in determining the procedures that must be followed when a business is deemed insolvent.[421] Defoe believed that one of the objectives of the law of insolvency is to identify debtors who have intentionally violated the ethical norms and principles of commercial activities.[422] The debtor should be captured and cast out punitively while his property is seized for the creditors. Thus, rogue debtors should be separated from honest debtors whose business has been demised, not because of their dishonesty.[423] The law should seek to protect and encourage honest debtors.

In an attempt to categorise debtors in accordance with their behaviours, Defoe postulated a four-part taxonomy of commercial actors, and I am interested in two principles: the honest debtor who fails by visible necessity, losses, sickness or decay of trade; and the extravagant debtor who fails because they have run out of estate in excess or on purpose to defraud the creditors. Defoe's idea of bankruptcy law offers voluntary sequestration with discharge and exemptions in exchange for disclosure of the debtor's property. Furthermore, he proposed that the debtor simply needs to attest that he is "unable to carry his business, because of losses and decay of trade".[424] To ensure that this standard is complied with, Defoe proposes that brutal sanctions should be imposed to punish the discordant and fraudulent debtor. I do not wish to adhere to Defoe's model of classification in its entirety but intend to borrow the idea that fraudulent debtors should be separated from honest debtors.

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418 Alistar 2019:358.

419 Micescu as cited by Alistar 2019:360.

420 Weisberg 1986:3-138. See also Quilter 2004:53-73; Tribe 2009:44-47.

421 Defoe 1697: section of bankrupts; see also Quilter 2004:53; Tribe 2009:45; Weisberg 1986:7.

422 Defoe 1697: section on bankrupts; see also Quilter 2004:53; Weisberg 1986:7.

423 Defoe 1697: section on bankrupts; see also Quilter 2004:54; Weisberg 1986:7.

424 Defoe 1697: section on bankrupts.

The proposed business rescue procedure for UBEs should be strictly reserved for honest debtors. Honest debtors in this context are entrepreneurs who fall into bankruptcy as a result of unforeseen circumstances such as global recession, natural disasters or market changes.[425] The behaviour of the entrepreneur before financial distress and during attempts to rescue, is important. A good example of Defoe's idea is found in England. Under IA 1986, based on the debtor's behaviour, a court may restrict the debtor from obtaining a DRO[426] by issuing a debt relief restriction order. This order may be declared even after the debtor has obtained a DRO.

The European Law Institute recommends that "the honesty of a debtor should, however, not be tested on the first day of proceedings based on extensive filing requirements, but instead be scrutinised during the cause of proceedings by investigations of the court, an insolvency practitioner, informed public authorities (tax or social security agencies) and creditors (financing bank; trade creditor)".[427] I am of the view that the supervisor of the rescue procedure should be vested with managerial and investigative powers. In this regard, the supervisor should investigate the cause and circumstances of financial distress. More so, the supervisor must look into the debtor's conduct before and after applying for business rescue.[428]

2.3.4 Legal personality

Critics may argue that it is not possible to implement a rescue procedure for UBEs since they are not recognised as legal persons.[429] The sole proprietor is liable for all expenses and liabilities of the business and shares the same fate with partnerships.[430] It is not suggested that sole proprietorship and partnerships must be granted legal personality in the same way as an incorporated company.[431] The European Law Institute recommends that the legislature should "lower the complexity and duration of small business cases in order to limit costs, but also to facilitate the access to procedures for average skilled sole entrepreneurs".[432] Unlike in South Africa, in the

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425 This does not mean that anyone who falls into bankruptcy other than because of unforeseen circumstances is not an 'honest debtor.

426 *Insolvency Act* 1986:sec. Sch 4ZB par. 1(1).

427 European Law Institute 2017: Recommendation 10.07.

428 Details about the investigative powers of the supervisor are discussed in Chapter 4.

429 Harduth 2017:6; see also Cilliers *et al* 1992:2.

430 David & Geach 2019:410; see also Davis *et al* 2010:205-210.

431 *Companies Act* 2008:14; see also Cassim *et al* 2012:106-11; Davis *et al* 2010:30-35.

432 European Law Institute 2017: Recommendation 10.5.

United States, UK and Kenya there are statutes which permit UBEs to file for business rescue. For these reasons, I posit that UBEs should be treated as follows:

2.3.4.1 Sole traders

Businesses conducted by sole traders have long been ignored, mainly because the insolvency of the debtor cannot be separated from the business. However, the business of a sole proprietorship has been slowly gaining the characteristics of a legal person. For instance, a sole proprietorship may assume a fictitious business name, can be sued or sue in its own name and taxed. Considering these factors and its contribution to the economy, I postulate that sole proprietorships should be considered as business entities for purposes of business rescue. If this is not possible, a business rescue procedure should be designed exclusively for sole proprietors. The legislature in South African can be guided by Chapter 13 of the US Bankruptcy Code. Chapter 13 is dedicated to persons with regular income and sole traders. South Africa has a lot to learn from other countries. Chapter 3 examines different rescue procedures, including Chapter 13, available to UBEs.

2.3.4.2 Partnerships

Partnerships should be regarded as legal entities for the purposes of business rescue. South Africa does not recognise partnerships as separate legal persons. However, as an exception to the rule, partnerships are recognised as legal persons for purposes of taxation, set-offs, insolvency and other legal procedures. It is, thus, argued that partnerships should be recognised as legal persons for the purposes of business rescue proceedings. The UK IPO 1994 and Chapter 11 of the US Bankruptcy Code 1978 may assist South Africa in designing an effective rescue scheme.

2.4 CONCLUSION

The main objective of this chapter was to establish an elaborate and efficient eligibility criterion that is aimed at accommodating UBEs. I found that the proper classification of debtors for purposes of business rescue depends on the universality of the legislation. It appears that single unified legislation is better positioned to classify debtors than a combination of different legislation. The main problem in South Africa is that different legislation are promulgated to provide debt relief or business rescue to debtors. Two pieces of legislation provide some form of debt relief to UBEs, namely

the NCA 2005 and the CA 2008. The main objective of the NCA 2005 is to provide debt relief to consumer debtors, and juristic debtors, such as partnerships, are excluded from applying for such reliefs. Furthermore, the NCA 2005 is only meant for specific credit agreements and debtors whose annual return or asset value is within a specific threshold. This effectively excludes UBEs from applying for debt relief under the NCA 2005. It was also noted that the CA 2008 excludes UBEs because they are not a legal person as defined by the Act. The legislature has also attempted to include UBEs in Bill 2004, but the proposed Bill has not yet been finalised since 2004. Besides, it rather seems that if Bill 2004 was passed, their predicament would continue because the rescue schemes suggested by the Bill are the same as the ones appearing in the IA 1986, which I dismissed as problematic and ineffective. The situation is, however, not without hope; lessons from international and regional jurisdictions suggest that UBEs may require special procedures to accommodate their needs. In other jurisdictions such as the United States, UK and Kenya, debt relief and business rescue form part of single unified legislation. In these jurisdictions, debtors such as sole proprietorships have a variety of options and, more importantly, partnerships are recognised as legal persons or unregistered companies for purposes of business rescue. The following chapter analyses these procedures and attempts to draft a business rescue scheme that may apply to UBEs in South Africa.

Chapter 3
PROCEDURAL FRAMEWORK

3.1 INTRODUCTION

A business rescue procedural framework lays out the debtor's steps to restructure or reorganise its business.[1] This chapter answers the second research question: *What are the essential features of the business rescue processes of the selected jurisdictions*?

The chapter compares selected business rescue procedures employed in South Africa, the United States, the UK, and Kenya. The comparison aimed at identifying the features of the business rescue process necessary to recover or reorganise an unincorporated debtor in financial distress. Central to the discussion is the determination of principles intended to maintain a balance of interests of all stakeholders.

The chapter further focuses on five features of the business rescue process. First, the commencement procedure determines the parties that have the authority to initiate business rescue on behalf of the UBEs. Second, the business rescue moratorium. This feature defines the limits of creditors' rights during the business rescue. On that note, the chapter also explores the different approaches to the protection of the rights and interests of creditors. Third, the statement of proposals provides different restructuring strategies that may facilitate an effective and sustainable rehabilitation of UBEs in financial difficulties. Finally, the chapter explains the various ways to exit the business rescue process that may apply to UBEs.

3.2 SOUTH AFRICA

The business rescue procedure provided in Chapter 6 of CA 2008 provides an appropriate point of departure in determining the essential features of a business rescue procedure. Since the procedure is used to rescue companies, the primary

[1] European Law Institute 2017: par. 581: "The common way to incentivise coordination amongst stakeholders in insolvency, but also to structure their negotiations and to facilitate the success of such negotiations is to provide for a composition or plan procedure."

purpose of this section is to identify the best practices that can be included in the business rescue procedure for UBEs.

The rescue process in Chapter 6 consists of five essential features, namely: commencement procedures that are available to the debtor as well as the creditors; the moratorium that protects the debtor's assets during the business rescue; a guided business plan that provides BRPs with directions in designing a rescue plan for a specific debtor; an incentivised post-commencement financing plan; and three avenues for exiting the rescue process. The sections below explain each feature and examine its compatibility with UBEs.

3.2.1 Commencement procedures

Chapter 6 *Business rescue* provides two avenues to commence business rescue: voluntary and compulsory business rescue.[2] This section deals with the commencement procedure for both avenues and examines whether the same procedure can apply to UBEs.

3.2.1.1 Voluntary business rescue

According to section 129(2) of CA 2008, the board of directors may decide to commence voluntary business rescue procedures if the company is in financial difficulties and there appears to be a reasonable likelihood of saving the company.[3] This approach is in line with section 66(1) of CA 2008, which stipulates that the board of directors has the power to manage the business of the company. A majority of the board of directors must approve the resolution to begin business rescue.[4] It demonstrates an impersonal relationship between a company and its incorporators. As a result, the board will be free of shareholder interference when determining whether to place the company under business rescue.

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2 Department of Trade and Industry 2010:42: "Business rescue proceedings begin when the board passes a resolution that the company voluntarily begins business rescue proceedings, or when an affected person, such as a shareholder, creditor, employee or organised labour, applies to court for business rescue proceedings."

3 In *Panamo Properties (Pty) Ltd and another v Nel and Others NNO* 2015 (5) SA 63 (SCA) par. 23 the Supreme Court of Appeal held that: "The passing of a resolution to commence business rescue cannot readily be described as a procedural requirement. It is merely the substantive means by which the company may take that step. The board is under no obligation at all to take such a resolution, although, if it is financially distressed, it may be obliged to inform shareholders and creditors of the reasons for not doing so (s 129(7)). It cannot then be described as a 'requirement', much less a procedural requirement."

4 Bradstreet 2010:197; Cassim et al 2012:866.

There are three advantages to voluntary business rescue. First, the board of directors is not unduly influenced by shareholders. Second, the board has access to resources such as expertise[5] that may assist in deciding to commence business rescue. In practice, the directors engage with the chosen BRP to perform a pre-assessment of the company's affairs, business, and prospects in order to satisfy themselves that the company is a proper candidate for business rescue.[6] Therefore, it is assumed that the decision to commence business rescue is likely to be reached before the company is declared insolvent. Third, it avoids unnecessary delays and costs compared to compulsory business rescue, which may require filing with the courts.[7]

Although voluntary business rescue has many advantages for the company, the same approach cannot be adopted for UBEs. Unlike companies, sole proprietorships and partnerships are managed and controlled by their owners. Furthermore, the owners are personally liable for the debts and liabilities of the business. Therefore, the decision to commence business rescue may be tainted by self-interest rather than the desire to keep the business operating. If UBEs were allowed to commence business rescue on their own volition, without some measures to test their intentions, the business rescue procedure would be exposed to abuse. The previous chapter suggested the recognition of UBEs as legal entities. Even though it is necessary to distinguish the owner from the business, the artificial entity created is not immune from the influence of its owners.

Critics may argue that in private and large public companies, shareholders may also act as directors. For instance, *De Bruyn v Steinhoff International Holdings NV and Others.*[8] In this case, prospective shareholders made financial decisions based on false financial statements provided by the company's directors. The court ruled that

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5 King IV 2016: Principle 7 states that the governing body should comprise the appropriate balance of knowledge, skills, experience, diversity and independence for it to discharge its governance role and responsibilities objectively and effectively.

6 Levenstein 2016:310 added: "In practice, many directors are taking the conservative approach. They engage with the nominated business rescue practitioner to conduct what is not termed a 'pre-assessment' of the affairs, business and prospects of the company so as to be able to satisfy themselves that in fact the company is a proper candidate for business rescue."

7 Loubser 2010:50-51 argued that "[t]he procedure is … faster, simple and much less expensive to commence than judicial management. It allows the board of directors to act immediately once they realise that the company is heading for insolvency and needs the protection and the breathing space that business rescue proceedings will provide, during which a rescue of the company or its business can be attempted."

8 *De Bruyn v Steinhoff International Holdings N.V. and Others* (29290/2018) [2020] ZAGPJHC 145 (26 June 2020).

shareholders have a right of oversight in the governance of a company;[9] hence, the board's decision to commence business rescue may also be tainted by self-interest since shareholders can also be appointed directors.

Section 7 of the CA 2008 provides that the purpose of the Act is to provide for the effective rescue and recovery of companies in financial distress while balancing the rights and interests of all relevant stakeholders.[10] The relevant stakeholders in business rescue are the company, shareholders, creditors, employees and the community. It follows that section 129 requires the board of directors to commence business rescue if there are reasonable prospects of rescuing the company or achieving a better return for the creditors. If the directors are also the shareholders, they are required to meet the same standard. The CA 2008 imposes a fiduciary duty on the directors to protect the creditors and other stakeholders.[11] According to this duty, directors should not make decisions based on their personal interests. If the directors breach this duty, they are personally liable for any losses that may flow from their actions.[12]

With regard to UBEs, the interests of the business are the personal interests of the owners; therefore, the risk of undue influence is higher for UBEs than companies. Furthermore, Chapter 6 voluntary commencement was drafted only with companies in mind and thus may fail to provide adequate protection against undue influence from the business owners. For these reasons, section 129 cannot be adopted for UBEs in its current form because owners of UBEs may commence business rescue for their self-interest instead of the interests of other stakeholders. The comparative study, therefore, aim to address this gap by assessing the different ways in which other jurisdictions deal with UBEs.

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9 *De Bruyn v Steinhoff International Holdings N.V. and Others* 2020: par. 172.

10 *Companies Act* 2008:sec.7(k).

11 *De Bruyn v Steinhoff International Holdings N.V. and Others* 2020: par. 138. "The legal relationship between the directors and the company gives rise to fiduciary duties owed by the directors to the company."

12 *Companies Act* 2008:sec. 76 and 77. A breach of a duty specified in sec. 76(3)(c) may render a director liable in terms of sec. 77(2)(b): "in accordance with the principles of the common law relating to delict for any loss damage or costs sustained by the company as a consequence of any breach by the director". See also *King IV Principle 6,* which requires the board of directors to act in the best interests of the company.

3.2.1.2 Compulsory business rescue

An affected person[13] can apply to the court for an order placing a company under business rescue proceedings.[14] The term *affected person* includes any employee, trade unions, shareholders, and creditors.[15] Since the application to commence with business rescue must be approved by the court, frivolous, malicious applications intended to harass the company are discouraged.[16] The applicant must serve a copy of the application to the company, the Companies and Intellectual Property Commission[17] and any affected persons. The main merit of compulsory business rescue is that it permits any person affected by the company's financial distress to apply for business rescue. In addition, the directors of a company who may have voted against business rescue are bound by the court order issued in terms of section 131.

I posit that compulsory business rescue may not be compatible with the UBEs. If the procedure is applied in its current form, it may give rise to a legal quagmire. First, it should be borne in mind that UBEs have several affected persons. These include, for example, the personal and business creditors, trustees, heirs, spouses, and former partners in a partnership. The definition of the *affected person* in Chapter 6 is narrow and fails to accommodate all affected persons relating to UBEs.

Second, with regard to sole proprietorships, the compulsory business rescue of a sole proprietorship may be interpreted as modern-day peonage.[18] Peonage is a system

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13 *Companies Act* 2008:sec. 128 defines *affected person* as "(i) a shareholder or creditor of the company; (ii) any registered trade union representing employees of the company; and (iii) if any of the employees of the company are not represented by a registered trade union, each of those employees or their respective representatives."

14 *Companies Act* 2008:sec. 131(1); Cassim *et al* 2012:873; Davis 2019:272.

15 Bradstreet 2010:198; Levenstein 2016:281-282; Meskin ***et al*** 2011:444-445; *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd and Others* 2011 (5) SA 600 (WCC).

16 In respect of the court's jurisdiction to hear compulsory business rescue applications, see *De Bruyn v Conradie and other* (18679/11 and 4455/14) [2014] ZAWHC (31 March 2014). In the third case, the court concurred with the judgement in *Sibhakhulu Corporation (Pty) Ltd v Wedgewood Village Golf Country Estate (Pty) Ltd (Nedbank Ltd Intervention)* 2013 (1) SA 191 (WCC). The court held that it had jurisdiction to hear an application for business rescue or liquidation of a company whose principal place of business is situated in its area of jurisdiction. See also *Lonsdale Commercial Corporation v Kimberley West Diamond Mining* [2013] ZANHC 11 (17 May 2013) and *Philippus Johannes de Bruyn v Grandselect 101 (Pty) Ltd and another (NCK*) Case No 961/2013.

17 The CIPC was established by the *Companies Act* 2008 as a juristic person to function as an organ of state within the public administration, but as an institution outside the public service.

18 The opinion is derived from the US approach. The reason being that compelling a debtor to generate income for the benefit of creditors may amount to peonage. See section 303(a) of the Bankruptcy Code. The Bankruptcy Courts have, on several occasions, decided on this matter: *In re Carrow*, 315 B.R. 8, 16 (Bankr. N.D.N.Y. 2004); *In re Molina Y Vedia*, 150 B.R. 393, 399 (Bankr. S.D. Tex. 1992); *In re Noonan*, 17 B.R. 793, 799-800 (Bankr. S.D.N.Y. 1982).

whereby a debtor (peon) works for the creditor until the debt is fully paid.[19] In other words, the peon is subjected to compulsory service until the debt is discharged.[20] A comparison of peonage and compulsory business rescue of individuals reveals that the two ideologies are similar in that the debtor works or conducts business for the benefit of creditors. Therefore, compulsory business rescue as a sole proprietorship may not be welcome in South Africa, since section 13 of the Constitution of the Republic of South Africa, 1996 (hereafter Constitution) prohibits forced labour or servitude, stating that "no one may be subjected to slavery, servitude or forced labour".[21] Besides, no laws compel debtors to cooperate with creditors if they are not interested in rescuing the business.

The third problem relates to the public's opinion of compulsory business rescue. When an affected party applies for compulsory business rescue against a company, it becomes public knowledge. The stigma that follows insolvency or the likelihood that a debtor may be sequestrated may persuade clients, suppliers and the general public to disassociate from the UBEs. Suppliers may decide not to advance goods and resources. Clients may give other UBEs their tenders and mandates. Basically, compulsory business rescue in Chapter 6 may discourage other stakeholders from conducting business with UBEs. It is argued that companies have proven to survive such stigma because the goodwill of the business does not follow the owner, whereas UBEs rely on the reputation of their owners.

3.2.2 Moratorium

The most important feature of business rescue is the moratorium or stay of proceedings. When a company is placed under business rescue, an automatic moratorium prohibits affected persons from initiating or continuing legal proceedings against the company.[22] The moratorium allows the company to formulate and

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19 Gross 1990: 168 states that Requiring a debtor to work to repay his creditors to obtain a discharge is strikingly close to the condition of peonage, a form of involuntary servitude violative of the thirteenth amendment. Peonage is the prohibited condition in which individuals are forced to work to repay *168 their creditors.19 By permitting a discharge in bankruptcy only if a debtor works to obtain this benefit, Congress may have imposed an unconstitutional condition on bankruptcy discharge.

20 *Hodges v US* 203 U.S. 1, 27 S. Ct. 6, 51 L. Ed. 65 (1906) – overruled, in part, on other grounds by *Jones v Alfred H. Mayer Co*., 392 U.S. 409, 88 S. Ct. 2186, 20 L. Ed. 2d 1189, 1 Empl. Prac. Dec. (CCH) P 9832 (1968).

21 Constitution of the Republic of South Africa 1996:sec. 13.

22 Cassim 2017:421-422; Lawreson 2018:669; Naidoo et al 2018:2; Nwafor 2017:59-67;Potgieter 2016. 20-23.

implement a business rescue plan. More importantly, the moratorium ensures that all stakeholders are treated equally. Cassim ***et al*** observed that it would be impossible to restructure a financially distressed company without the moratorium.[23] The moratorium protects the company from harassment by its creditors.[24] Interference by creditors and affected parties may frustrate the prospects of a successful rescue.

A company in business rescue has extensive protection against affected parties who may seek recourse through legal proceedings. Section 133(a) and (b) of the CA 2008[25] provides that no legal proceedings can be instituted against the company or its property without the consent of the BRP or the court during the business rescue process.[26] It means that creditors or other affected persons are prohibited from taking legal action or enforcing their rights against the company. The only exception to this rule is that execution or enforcement action may be initiated with the consent of the BRP and with the court's permission. Since a moratorium is important, I considered including a moratorium on UBEs, which raises one critical question: *Does the business rescue moratorium in Chapter 6 protect the members and directors of the company?*

The answer to this question is negative: the moratorium in business rescue only protects the company and not its directors or shareholders. A company is a separate entity from its directors and shareholders.[27] For that reason, the insolvency of its shareholders does not affect the company. If a creditor commences sequestration proceedings against a shareholder's estate, the shareholder cannot evoke protection by section 133 of the CA 2008. If sole proprietorships and partnerships are treated as separate legal entities, the moratorium will only protect the business and not the

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23 Cassim ***et al*** 2012:897; Cremen ***et al*** 2019:10-11.

24 *Cloete Murray v Firstrand Bank Ltd t/a Westbank* 2015 (3) SA 438 (SCA): par. 14; *Chetty t/a Nationwide Electrical v Hart* 2015 (6) SA 424 (SCA): paras. 28 and 39; *Elias Mechanicos Building & Civil Engineering Contracts (Pty) Ltd v Stedone Developments (Pty) Ltd* 2015 (4) SA 485 (KZD): paras. 7,9 and 11; *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd* [2013] ZAGPJHC 109 (13/12406) 10 May 2013: par. 4.

25 *Companies Act* 2008:sec. 133(a) and (b). During business rescue, no legal, 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 (a)with the leave of the court and in accordance with any terms the court considers suitable.

26 Cassim 2018:40 stated: "The goals of business rescue must be carefully balanced with the prejudice caused to property owners by virtue of the moratorium during business rescue. The moratorium encroaches on the proprietary rights of third parties, who are unable to recover their property from a company during business rescue."

27 *Salomon v A Salomon & Co Ltd* [1897] AC 22 (HL). In this case, the court held that once a company is legally incorporated, it must be treated like any other independent person with rights and obligations applicable to it. See also *Airport Coldstorage Pty Ltd v Ebrahim* 2008 (2) SA 303 C; *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530:550-551.

owner. Accordingly, partners and sole traders will be treated as members. Treating sole traders and partners the same way as shareholders without extending the moratorium may render the business rescue process ineffective. The rescue of UBEs depends on the contributions of the owner of a sole proprietorship and partners in a partnership. Therefore, although UBEs may enjoy the protection of the moratorium, the main contributors of business rescue remain exposed to compulsory sequestration proceedings. The relationship between UBE owners and their enterprises is so intimate that the sequestration of one impacts the other. The law should therefore provide a moratorium that protects the business as a legal entity and the owner as a contributor to the rescue process. As it stands, the Chapter 6 moratorium only protects the business and exposes the owners to sequestration proceedings.

3.2.3 Business rescue plan

An important aspect of the Chapter 6 business rescue is the preparation of a relatively clear plan of action to guide the company from its financial troubles to be a successful enterprise once again. [28] For this reason, I consider the business rescue plan as an indispensable feature of an effective business rescue scheme for UBEs.

Generally, the plan must set out the company's history, its financial background and the practitioner's recommendations. CA 2008 provides a template that should be considered in developing a business rescue plan. Section 150(2) divides the rescue plan into three parts: Part A deals with the background, Part B provides the basic contents of the business rescue proposal, and Part C deals with the assumptions and conditions.

Section 150 only provides the minimum requirements for a business rescue plan. The practitioner may add or omit some of the requirements depending on the facts of each case. Although the legislature provides guidelines for the BRP in developing a rescue plan, some of the requirements may be difficult to apply to UBEs. The following sections discuss each requirement and assume that UBEs should meet the same requirements. I discuss selected elements of the business rescue plan, including the list of assets, proof of claims, and the practitioner's remuneration.

[28] Kloppers 1999:427; see also Burdette 2004b:438; Mutsa 2011:31; Snyman-Van Deventer & Jacob 2014:103.

List of assets

Section 150(2)(a) stipulates that a business rescue plan should contain a list of all company assets. The list is meant to show the company's net value and whether any properties can be sold to increase its liquidity. In the case of a sole proprietorship, it means that the plan must provide a list of assets owned by the debtor.

I am of the opinion that a business rescue plan for a sole proprietorship should be developed based on the property used by the owner to conduct business. The problem arises when attempting to classify whether the property was used for either business or private purposes. This problem emanates from two sources, namely the matrimonial regime and whether the owner kept proper business documentation.

The matrimonial regime may pose a challenge in that when the owner buys property for the business, it does not become the property of the business. It remains the property of the matrimonial estate in cases where the parties are married in community of property.[29] There is then a need for consent from the other spouse before selling the property to rescue the business.[30] It may be difficult and cumbersome for the BRP to secure the cooperation of the other spouse who may not be engaged in the same business. In addition to this dilemma, if the owner does not keep proper documentation, it may be difficult to determine whether the property in question was even used for business.

Special provisions should be set up to provide a proper guide to determine the property that should be considered as the estate of the business for the purpose of business rescue. Regarding partnerships, this implies that the debtor must provide a list of

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29 *Matrimonial Property Act* 88/1984 sec. Chapter 1. The matrimonial systems may be either in community of property or out of community of property and also if the accrual system is accepted. See also the *Recognition of Customary Marriages Act* 120 of 1998:sec. 8. Since Muslim marriages are now recognised as valid marriages, the matrimonial property regimes of such marriages are regulated in terms of Muslim law. *President of the RSA and Another v Women's Legal Centre Trust and Others*; *Minister of Justice and Constitutional Development v Faro and Others*; and *Minister of Justice and Constitutional Development v Esau and Others* (Case no 612/19) [2020] ZASCA 177 (18 December 2020).

30 *Matrimonial Property Act* 88/1984, sec. 15 states that "a spouse in a marriage in community of property may perform any juristic act with regard to the joint estate without the consent of the other spouse. (2) Such a spouse shall not without the written consent of the other spouse (a) alienate, mortgage, burden with a servitude or confer any other real right in any immovable property forming part of the joint estate; (b) enter into any contract for the alienation, mortgaging, burdening with a servitude or conferring of any other real right in immovable property forming part of the joint estate; (c) alienate, cede or pledge any shares, stock, debentures, debenture bonds, insurance policies, mortgage bonds, fixed deposits or any similar assets, or any investment by or on behalf of the other spouse in a financial institution, forming part of the joint estate; (d) alienate or pledge any jewellery, coins, stamps, paintings or any other assets forming part of the joint estate and held mainly as investments."

assets owned by the partnership estate and preferably the partners. I am of the view that creditors should know what the assets used for the partnership business owns and make an informed decision whether to support or object to business rescue. Since partners are the primary contributors to the rescue process, a list of their business assets may assist the practitioner in assessing whether there are reasonable prospects of rescuing the partnership business.

Proof of claims

The debtor should provide a complete list of the creditors of the company and must specify whether the creditors qualify as secured, statutory preferent, and concurrent in terms of the laws of insolvency. The list must also specify which creditors have proved their claims.

Since the insolvency of UBEs is overseen by multiple legislation, including IA 1936 and NCA 2005, the classification of creditors may prove to be a mammoth task. The owner of a sole proprietorship has many creditors, ranging from personal to business creditors. In developing a business plan, it is suggested that personal creditors should be separated from business creditors. The rationale for distinguishing the creditors is that business creditors are more exposed to high risk if the business fails than personal creditors. Without the cooperation of business creditors, the whole idea of rescuing a sole proprietorship may not be feasible.

When dealing with partnerships, determining whether the partnership estate or the partner owes a creditor may prove to be problematic. [31] For example, if a creditor's claim is maintainable in *solidium*, the debt may be lodged in both the partnership's estate and in the estate of a partner.[32] Additionally, Chapter 6 lacks provisions addressing a director's claim against the company. It effectively means that it will be unclear whether partners will continue to be liable for the business's debts or even be deemed creditors under the business's rescue plan. These issues may have a negative impact on the effectiveness of the Chapter 6 business rescue.

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31 *Michelsohn's Trustee v Assistant Master* 1918-23 GWT 178; *Mishalow NO v Premier Milling Co Ltd* 1960 (2) SA 59 (W) at 61-4. *Cassim v The Master* 1962 (4) SA 601 (N): The difficulty arises from the fact that although a partnership estate is separate from a partner's estate, this does not change the original nature of the debt.

32 *Estate Wilson v Estate Giddy, Giddy & White* 1937 AD 239; *Blackwood Hodge (Rhodesia) (Pty) Ltd v Duff NO* 1961 (2) SA 205 (SR).

The business rescue practitioner's remuneration

The business rescue plan should also include a written agreement concerning the remuneration of the BRP. The main obstacle to pursuing business rescue in Chapter 6 is that the proceedings are expensive, and most UBEs lack resources.[33] Regulation 128 of the Companies Regulations 2011 provides a guideline for BRP tariffs. In the case of a small company, a BRP cannot claim more than R15 625 per day. At the same time, business rescue is allowed to run for about three months.[34] The Small and Medium Enterprises Agency (the Agency) reported that in the last quarter of 2019, the average annual return for small enterprises was R900 000.[35] With that being said, it seems that a small company may need to have approximately R1 350 000 to remunerate a single BRP.[36] Meskin noted that the business rescue procedure has become inaccessible considering the rather liberal hourly and maximum daily tariff for the practitioners.[37] A UBE may not even survive for a month under rescue. The present expenses attached to the Chapter 6 business rescue may render the entire rescue effort unfeasible.[38]

3.2.4 Post-commencement finance

When a financially distressed company is placed under business rescue, it requires additional finances to meet its operational expenses until the rescue plan is developed and implemented.[39] Hence, in the contemplation of promulgating a business rescue scheme for UBEs, post-commencement finance should form one of its pillars. Scholars such as Burdette described it as the "most important, most problematic aspect of a successful business rescue model".[40] Section 135 was designed to allow a company

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33 See proposals in Chapter 4.

34 *Companies Act* 2008:sec.132(3): "If a company's business rescue proceedings have not ended within three months after the start of those proceedings, or such longer time as the court, on application by the practitioner, may allow, the practitioner must- (a) prepare a report on the progress of the business rescue proceedings, and update it at the end of each subsequent month until the end of those proceedings."

35 Small and Medium Enterprises Agency, First Quarter Report 2019:23.

36 *Companies Act* 2008:sec. 143(6): The Minister may make regulations prescribing a tariff of fees and expenses. See Companies Regulations 2011:sec. 128.

37 Meskin 2016:666. See also McKay 2019:11.

38 McKay 2019:11. See suggestion in Chapter 4 section 4.2.2.3.

39 Jones 2018:9; Pillay et al. 2020:236-244; Pretorius & Smith 2014:108-39; Rushworth 2010:375-408.

40 Burdette 2004:51; see also Calitz & Freebody 2016: 265-267; Cassim *et al* 2012:882; Costa & Braybrooke 2018:10-11.

in financial distress to secure further finances during the business rescue process.[41] To encourage creditors to support business rescue, section 135 provides that any credit extended for restructuring the business will have priority over debts advanced to the company before business rescue.[42]

CA 2008 has attempted to strike a balance of interests between post-commencement creditors and the debtor company. On the one hand, the company is allowed to outsource more funds even though it is experiencing financial distress. On the other hand, post-commencement creditors enjoy preferential rights. Although this incentive allows creditors to finance the business rescue process, two issues arise when dealing with UBEs: First, UBEs are generally not well capitalised to secure further funding; and second, the issue of ranking of creditors will require a harmonious application of the IA 1936 and CA 2008.[43] The following discussion deals with these problems extensively.

The first problem that may be encountered in using Chapter 6 for post-commencement finance is that many UBEs in South Africa do not have the assets to secure postcommencement finance. A thorough analysis of the SEDA Quarterly Report 2019 shows that the nominal turnover of SMEs increased by only 0.4 per cent in the first quarter of 2019, which is significantly below the 6.2 per cent turnover growth of large enterprises and the inflation rate of 4.3 per cent.[44] This stagnant turnover level forces

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41 *Companies Act* 2008:sec. 135: "During its business rescue proceedings, the company may obtain financing other than as contemplated is subsection (1), and any such financing (a) may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise encumbered; and (b) will be paid in the order of preference set out in subsection (3)(b)."

42 *Companies Act* 2008:sec. 135: "To the extent that any remuneration, reimbursement for expenses or other amount of money relating to employment becomes due and payable by a company to an employee during the company's business rescue proceedings, but is not paid to the employee— (a) the money is regarded to be post-commencement financing; and (b) will be paid in the order of preference set out in subsection (3)(a). (2) During its business rescue proceedings, the company may obtain financing other than as contemplated in subsection (1), and any such financing— (a) may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise encumbered; and (b) will be paid in the order of preference set out in subsection (3)(b). (3) After payment of the practitioner's remuneration and costs 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 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."

43 The former deals with the ranking of creditors during insolvency whereas the latter specialises with the liquidation of companies to the exclusion of UBEs. The problem is that the two pieces of legislation are founded on two conflicting ideologies. That is, under the law of insolvency, the debts and liabilities of the business (sole proprietorship and partnerships) are also the debts and liabilities of the owner of the business.

44 Small and Medium Enterprises Agency 2019:22-23.

SMEs to keep their expenditure under control by cutting on all expenses, except labour and capital. As a result, profit levels remained unchanged. Nevertheless, the general financing of UBEs depends on the creditworthiness of the owners of the business instead of the business itself. For this reason, I am convinced that many UBEs in financial distress will not be in a position to secure further investments.

The second problem pertains to the ranking of creditors. In *Merchant West Working Capital Solutions (Proprietary) Limited v Advanced Technologies & Engineering Company*,[45] Kgomo J provided a comprehensive and almost intact ranking of creditors. The court arranged creditors in the following order: on top of the list are professional expenses, including auditors', lawyers' and accountants' fees. This class of creditors is followed by employees' salaries, which become due and payable after the commencement of business rescue. Ranking at the third position is secured creditors who extended credit during the business rescue, known as postcommencement financiers, followed by unsecured creditors who also supported business rescue. At the bottom of the list are secured creditors who lend or supplied the company before the commencement of business rescue.[46] While this case clarifies major issues regarding the interpretation of section 135 and the ranking of creditors, there are further issues that require attention. One such issue is whether the ranking created by section 135 of CA 2008 remains in force where business rescue has failed, and the company is placed under liquidation. In other words, it is not clear whether the insolvency proceedings reverse or endorse the ranking of creditors created by business rescue provisions.

If the answer to this question is positive, the classification of creditors remains the same as during business rescue. It implies that some secured creditors become

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45 *Merchant West Working Capital Solutions (Proprietary) Limited v Advanced Technologies & Engineering Company (Proprietary) Limited & Gainsford* (Unreported, Case No 2013/12406).

46 *Merchant West Working Capital Solutions (Proprietary) Limited v Advanced Technologies & Engineering Company (Proprietary) Limited & Gainsford* 2013: par. 21. The court arranged creditors in the following order: "1. the fees and expenses (including legal and other professional fees) of the business rescue practitioner incurred during business rescue proceedings (s135(3)); 2. the fees of employees, which become due and payable after the commencement of business rescue (s135(3)(a)); 3. secured lenders or creditors for any loan or supply made after the commencement of business rescue (that is, secured post-commencement financiers) (s135(3)(a)(i) and s135(3)(b)); 4. unsecured lenders or creditors for any loan or supply made after the commencement of business rescue (that is, unsecured post-commencement financiers) (s135(3)(a)(ii)); secured lenders or creditors for any loan or supply made before the commencement of business rescue; claims of employees (for instance for remuneration, which became due and owing before the commencement of business rescue; and unsecured lenders or creditors for any loan or supply made before the commencement of business rescue (that is, concurrent creditors)."

unsecured creditors. Therefore, the claims of secured creditors who decide not to support the business rescue endeavour are not satisfied out of the security they hold, but out of the residue after various creditors who rank first, are paid.[47] To put it another way, post-commencement creditors, which include the BRP, employees and unsecured creditors, will be paid first before secured creditors are considered. Such an outcome is undesirable because it only encourages creditors to extend credit on strict terms and conditions, which means that UBEs may find it difficult to secure startup loans.

If the answer is negative, meaning that the insolvency laws will apply, then there will be no incentive for the BRP or employees to cooperate in the rescue process. Without the cooperation of the creditors, practitioners and employees, the attempt to rescue a business regardless of its legal form or size will fail.[48] I opine that a separate rescue scheme for sole proprietors and partnerships must be promulgated in harmony with other legislation such as IA 1936 and NCA 2005. The legislature must attempt to balance the interests of pre-insolvency creditors and post-commencement financiers.

3.2.5 Discharge from business rescue

It is accepted among scholars and practitioners that a company in financial distress has the best chance of surviving if business rescue commences early and the plan is implemented within a short period. For this reason, the business rescue procedure for UBEs should be completed within a reasonably short time.

The Chapter 6 business rescue procedure is intended to take no more than three months.[49] If the BRP opines that the company needs more than three months they may apply to the court for an extension. However, the BRP is not compelled to make such an application. Instead, the practitioner may choose to compile monthly reports and deliver them to the affected parties and the court or the Commission.[50] From section 132, it is clear that business rescue ends when the court has issued an order by setting aside the resolution for business rescue,[51] where the practitioner has issued

47 Barnett & Levenstein 2013:10-11.

48 Barnett & Levenstein 2013:10-11.

49 *Companies Act* 2008:sec. 132(3).

50 *Companies Act* 2008:sec. 132(3).

51 *Climax Concrete Products CC t/a Climax Concrete Products CC v Evening Flame Trading 449 (Pty) Ltd and Others (ECP)* (unreported case no 812/2012, 21-6-2012): "This is regulated by section 130 that states that,

a notice of termination to the Commission,[52] or where the practitioner has filed a notice of substantial implementation of the plan.[53] The first two scenarios are achievable within a short time, and in most cases, the rescue procedure would have failed. However, if the practitioner issues a notice of substantial implementation of the plan, it means that the business rescue procedure may have rehabilitated the business, or a better return for creditors would have been achieved.

The provisions in Chapter 6 may not facilitate the discharge of UBEs mainly because the time frame is short and UBEs have continuous debts. UBEs are owned by individuals who incur both business and consumer debtors. Business debts are easy to discharge during the business rescue, but consumer debts are difficult to clear within three months because they are personal in nature. Consumer debts include survival and relational debts. Survival debts include expenses for food and clothing, monthly rental payments, medical bills and school fees for children.[54] These types of debts are necessary for the survival of the debtors. Relational debts are acquired through connection with others because of marriage, other relationships or death.[55] They usually arise by operation of law as a result of liabilities being incurred by a spouse. An example of relational debt is maintenance expenses. I suggest that a separate business rescue scheme for UBEs is necessary to deal with such issues. As it stands, Chapter 6 may only guarantee a discharge of business debts but not consumer debts.

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subject to subs (2), at any time after the adoption of a resolution in terms of section 129, until the adoption of a business rescue plan in terms of section 152, an affected person may apply to a court for an order setting aside the resolution, on the grounds that there is no reasonable basis for believing that the company is financially distressed; there is no reasonable prospect for rescuing the company; or the company has failed to satisfy the procedural requirements set out in s 129."

52 Such notice may be filed in terms of the *Companies Act* 2008:sec.141: "if the practitioner has investigated the company's affairs, business, property, and financial situation, and after having done so, considered whether there is any reasonable prospect of the company being rescued. Section 141(2)(b) further stipulates that if, at any time during business rescue, the practitioner concludes that there are no longer reasonable grounds to believe that the company is financially distressed, the practitioner must so inform the court, the company, and all affected persons in the prescribed manner. If the business rescue process was confirmed by a court order in terms of s 130 or initiated by an application to the court in terms of s 131 the practitioner must then apply to the court for an order terminating the practitioner or otherwise file a notice of termination of the practitioner."

53 *Companies Act* 2008:sec. 132(2). See also *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd and Another (Advantage Project Managers (Pty) Ltd intervening)* 2011 (5) SA 600 (WCC); *Newcity Group (Pty) Ltd v Pellow NO and Others, China Construction Bank Corporation Johannesburg Branch v Crystal Lagoon Investments 53 (Pty) Ltd and Others (GSJ)* (unreported case no 12/45437, 16566/12, 28-3-2013); *Commissioner, South African Revenue Service v Beginsel NO and Others* 2013 (1) SA 307 (WCC).

54 INSOL International 1997:3-5.

55 INSOL International 1997:3-5.

3.2.6 Summary

The business rescue procedure in Chapter 6 aims to provide some form of relief for debtors in financial distress. It appears that an effective business rescue should at least have five major cornerstones. First, the procedure should provide some form of commencement procedure that allows either the debtor or the creditor to initiate proceedings. Secondly, to sustain the procedure, a moratorium should be imposed on all legal proceedings against the members of the UBE and its property. Third, the procedure should have guidelines for the drafting of the business rescue plan. Fourth, a plan to secure post-commencement finance. Fifth, an exit or discharge strategy from the business rescue process should allow the debtor to continue with its business.

However, the business rescue procedures in Chapter 6 of CA 2008 may fail to rescue UBEs because they were not designed to accommodate the specific needs of UBEs. The laws applicable to companies are fundamentally different from those that govern the administration of sole proprietorships and partnerships.

The commencement procedure under business rescue is founded on the assumption that the board of directors are acting in the best interest of the company. This may not be the case for UBEs. The owners are liable for the debts and liabilities of the UBEs and this is an incentive enough for them to abuse voluntary commencement. A good faith requirement is needed. If the creditor commences business rescue, there are no guarantees that the owners of UBEs will cooperate. At worst, compelling the owner of a sole proprietorship may be regarded as contrary to the Constitution, 1996.

Besides commencement problems, designing a business rescue plan for a partnership or sole proprietorship may prove difficult considering that the debts of the partnerships are also the debts of the partners who are not protected by the moratorium. More so, securing post-commencement finance may prove impossible since most of the UBEs are undercapitalised to secure further financing. Creditors who may be willing to extend credit may be discouraged by the fact that the classification of creditors is not certain. Considering that sole proprietorships and partnerships are regulated by IA 1836, it may be complicated to harmonise the rights of creditors before business rescue and post-commencement creditors. For these reasons, I opined that Chapter 6 may not effectively facilitate the rescue and rehabilitation of sole proprietorships.

Although integrating sole proprietorships and partnerships into the Chapter 6 business rescue process may not be optimal, the rescue procedure provides the following valuable lessons: First, before commencing business rescue, the BPR should be given an opportunity to conduct a pre-assessment of the debtor's financial situation. This saves time and resources because not all debtors can be saved. Second, the moratorium in business rescue is meant to protect the business and its property. This may benefit UBEs because some of the businesses heavily rely on property to generate revenue. Third, Chapter 6 shows that the rescue plan should consider all the debtor expenses, including administrative, operational and professional expenses. It is better to know the cost of business rescue before attempting to rescue the business. Fourth, it is important to incentivise the contribution of rescue financiers by guaranteeing preferential rights. This approach encourages post-commencement financiers to invest in the business. Basically, Chapter 6 provides an example of an effective business rescue process.

The United States has grappled with issues similar to those faced by South Africa. The next section explores the various rescue processes, as well as their difficulties and potential solutions.

3.3 UNITED STATES OF AMERICA

The different business reorganisation schemes in the United States provide a practical guide for the development of a rescue procedure for UBEs. This section discusses special provisions for sole proprietorships[56] and partnerships[57] in the Bankruptcy Code, namely Chapters 11 and 13.[58] The analysis is meant to identify the best practices when setting up a business rescue procedural framework for an unincorporated debtor in financial distress. The section begins with an examination of the rescue process that applies to sole proprietorships in Chapter 13 of the Bankruptcy Code.

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56 *Bankruptcy Code* 1978: Chapter 13.

57 *Bankruptcy Code* 1978: Chapter 11.

58 It should be noted that Chapter 11, 12, 13 and 15 of the *Bankruptcy Code* were promulgated to assist debtors in financial difficulties. However, Chapter 7 proceedings are liquidation proceedings and any debtor who wishes to avoid sequestration or liquidation should apply for reorganisation in Chapter 11 or 12 or 13. I only focus on Chapter 11 and 13.

3.3.1 Chapter 13 – Reorganisation process for sole proprietorships

The basic idea of the Chapter 13 reorganisation process is to allow the debtor to make payment in compliance with an approved reorganisation plan.[59] The debtor's main task is to obtain approval of its plan that provides for the payment of creditors and emerge at the end of the process with as much valuable property as possible.[60] This process provides a way for a debtor to obtain a discharge[61] and continue operating the business on a solvent basis.

This part explores selected features of the Chapter 13 process to determine the following aspects: the commencement procedure; the scope and limitation of the moratorium; the treatment of creditors during business reorganisation; the financing of the process; and the different ways or circumstances for the discharge of the debtor.

3.3.1.1 Commencement procedure

The owners of sole proprietorships may commence a Chapter 13 case by filing petitions to the district court where they reside or conduct business.[62] A married couple may also file a joint application in terms of section 301 if one of the spouses is eligible to be a debtor under Chapter 13. It is possible for a debtor who is already subject to

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59 Numerous empirical studies have been conducted between 1989 and 2017 evaluating the success and failures of Chapter 13. Hildebrand 1994:16 reporting that Chapter 13 trustees estimated a completion rate of 32.89 per cent based on their experiences; Sullivan *et al.* 1989, estimating that one-third of 1 529 Chapter 13 cases in their study completed plan payments.

60 Eraslan *et al* 2017:673 posited that the failures of Chapter 13 are mainly caused by stringent confirmation requirements. For instance, a Chapter 13 case may be dismissed for failing to meet the *steady income test*. In view of these demerits it seems that a debtor under Chapter 13 should be involved in some form of business to manage the cost of proceedings and guarantee a substantial implementation of the reorganisation plan.

61 *Grogan v Garner*, 498 U.S. 279, 286-287, 111 S. Ct. 654, 112 L. Ed. 2d 755, 21 Bankr. Ct. Dec. (CRR) 342, 24 Collier Bankr. Cas. 2d (MB) 1, Bankr. L. Rep. (CCH) P 73746A, 70 A.F.T.R. 2d 92-5639 (1991): A perusal of courts records for the period 2019–2020 shows that over 200 000 cases were filed under Chapter 13 cases and 1 769 were classified as business cases (the debts were predominately closely linked to the business). It is important to stress that court records do not show whether a debtor was discharged or whether creditors were fully paid. As such, the available statistics only shows that sole proprietorships do file under Chapter 13 and the outcomes of their cases are reported under consumer debtors. On that note, I am of the view that the success of the Chapter 13 process should be viewed with a certain degree of optimism since its outcomes on sole proprietorships remain speculative. Bankruptcy Courts – Business and Nonbusiness Cases Commenced, by Chapter of the Bankruptcy Code, during the 12-month period ending September 30, 2019.

62 *Bankruptcy Code* 1978:sec. 301 (a): A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter. See also Treister 1988. 17-26.

the Chapters 7[63] or 11[64] proceedings to request that these cases be converted to a Chapter 13 process. The main advantage of conversion is that the debtor has the opportunity to avoid liquidating its business by reorganising its business under the Chapter 13 rescue process.

However, creditors cannot convert Chapters 7 or 11 cases without the debtor's consent.[65] It is also interesting that creditors cannot commence a compulsory Chapter 13 case against the debtor. According to the legislative history, Congress did not wish to contravene the constitutional prohibition against an involuntary servitude.[66] Gross argued that requiring a debtor to work to repay his creditors to receive a discharge is eerily similar to peonage, a type of forced servitude that violates the thirteenth amendment.[67] In *In re Carrow*,[68] the United States Bankruptcy Court, N.D. New York held that even the courts do not have the authority to convert any Chapter (7, 11 and 12) case in the *Bankruptcy Code* 1978 to a Chapter 13 reorganisation unless the debtor consents.[69] It appears that any commencement of the Chapter 13 reorganisation case should be initiated or consented to by the debtor.

When filing a Chapter 13 petition, the debtor should include a list of creditors (both personal and business creditors), a verified statement that contains a Social Security number, or that indicates that the debtor does not have one. More importantly, the debtor must pay the filing fee and submit a signed petition timeously.

The issue of signing the petition caused problems to some debtors. At the onset, the *Bankruptcy Code* 1978 and the *Bankruptcy Rules* 2015 do not express that the debtor

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63 It should be noted that Chapter 7 provides for liquidation and sequestration proceedings and the *Bankruptcy Code* 1978:sec. 706(a) provided that "[t]he debtor may convert a case under this chapter to a case under Chapter 11, 12, or 13 of this title at any time, if the case has not been converted under section 1112, 1208, or 1307 of this title. Any waiver of the right to convert a case under this subsection is unenforceable."

64 *Bankruptcy Code* 1978:sec. 1112(d). The court may convert a case under this chapter to a case under Chapter 12 or 13 of this title only if– (1) the debtor requests such conversion; (2) the debtor has not been discharged under section 1141(d) of this title; and (3) if the debtor requests conversion to Chapter 12 of this title, such conversion is equitable.

65 *Bankruptcy Code* 1978:sec. 1208(a) permits conversion of a Chapter 12 case only to Chapter 7.

66 House Assembly Report 1977:95 Involuntary commencement is regarded as forcing the debtor to work for the benefit of creditors.

67 Gross 1997:167; Involuntary cases may not be filed under Chapter 13, which means that an individual debtor cannot be forced to subject his or her income to the requirement of paying creditors to receive a discharge in Chapter 13 reorganisation.

68 *In re Carrow*, *United States Bankruptcy Court, N.D. New York.* September 8, 2004 315 B.R. 853 Collier Bankr. Cas. 2d 14.

69 *In re Carrow* 2004:6-17. A conversion would violate sec. 706 (c), which specifically prohibits the court from converting a Chapter 7 case to one under Chapter 13, unless the debtor requests conversion.

signs the petition. However, the official form, which must be included in the petition, requires the debtor and the representing attorney to sign the document. Hence, by operation of *Bankruptcy Rule* 2015 (Rule 1008), the debtor is required to sign the petition as the individual praying for bankruptcy relief. A petition without the debtor's signature is regarded as a legal nullity subject to dismissal. However, if the debtor authorises the filing of the case, the fact that it is not signed, only amounts to a procedural defect that may be cured.[70] Moreover, a bankruptcy court may take judicial notice of the debtor's participation in the proceedings as evidence that the debtor ratified the initiation of the case.[71] Furthermore, the debtor may be estopped from seeking the dismissal of the Chapter 13 case based on the enjoyment of the moratorium granted by the procedure.[72] Recent amendments to the *Bankruptcy Code* 1978 have turned the tides of filing a petition under Chapter 13. *Bankruptcy Rule* 2015 (Rule 5005), effective from 1 December 2018, makes it mandatory for entities represented by an attorney to file documents electronically.[73] However, an individual not represented may file electronically only with the approval of the court.[74] The Rule provides that filing through an electronic account and authorised by the debtor, along with the debtor's name on the signature block, constitutes the petitioner's signature.[75] The new procedure makes it easy for joint petitions where the other spouse cannot sign the petition physically. I believe that requiring the petitioner to sign, prevents creditors from filing the petition on behalf of the debtor and later forcing or persuading the debtor to consider reorganisation. Furthermore, the legislature in South Africa should consider providing a procedure that can be commenced electronically. The advantages of using an electronic process are that it may reduce the cost of

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70 *In re Rice* 521 B.R 405 (Bankr. N.D Ga. 2014). *In re Rice*, the wife of the debtor had forged her husband's signature. The trustee applied for the dismissal of the joint case on the ground that the signature was not in fact that of the husband. The court ruled that the lack of signature does not deprive the court jurisdiction to hear the matter.

71 *In re Willis*, 345 B.R. 647 (B.A.P. 8th Cir. 2006); *In re Benton*, 75 Collier Bankr. Cas. 2d (MB) 188, 2016 WL 721487 (Bankr. E.D. Mich. 2016). But *see In re Eicholz*, 310 B.R. 203, 208–09 (W.D. Wash. 2004) (wife holding power of attorney did not have authorisation to file petition on husband's behalf, and he did not ratify petition despite a three-month delay in opposing his inclusion in the petition).

72 *In re Todd*, 2015 WL 5042116 (Bankr. N.D. Ga. 2015): Case dismissed where debtor did not sign the petition and it was questionable whether the debtor gave authorisation to file petition. Passage of time and the benefits of the automatic stay are not sufficient to ratify an unauthorised filing. See also *In re Amir*, 436 B.R. 1, Bankr. L. Rep. (CCH) P 81835 (B.A.P. 6th Cir. 2010); *In re Brown*, 163 B.R. 596, 598 (Bankr. N.D. Fla. 1993) (death of the debtor may prevent ratification).

73 *Bankruptcy Procedure* 2016: rule 5005(B)(i).

74 *Bankruptcy Procedure* 2016: rule 5005(B)(i).

75 *Bankrutpcy Procedure* 2016: rule 5005(a)(2)(c).

proceedings, debtors will not have to queue for such a service, and most importantly, case management may prove effective.

3.3.1.2 Automatic stay in Chapter 13

One of the most important features of Chapter 13 is section 362. This section imposes an automatic stay that is effective from the date and time the debtor files a Chapter 13 case.[76] The automatic stay is meant to protect and activate the bankruptcy court's exclusive jurisdiction over the debtor's estate.[77] The primary goal of the stay is to provide the debtor with a "breathing spell", while preparing a proposal to satisfy its outstanding obligations. Furthermore, it protects the rights and interests of creditors. It prevents other creditors from enforcing their rights against the debtor's estate and creating a sense of panic among creditors who have not been paid.[78] In *Mann v Chase Manhattan Corp*, the Bankruptcy Court held that "[t]he automatic stay provision is designed to forefend against the disorderly, piecemeal dismemberment of the debtor's estate outside bankruptcy proceedings."[79]

The acts prohibited by the automatic stay are stated in section 362.[80] That section prohibits the following: legal proceedings, or enforcement proceedings against the debtor or the property of the debtor's estate; the creation or enforcement of a lien

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76 The *Bankruptcy Code* 1978:sec. 362(a) emphasises that the bankruptcy petition itself operates as a stay. Consequently, it applies upon the commencement of an involuntary case in section 303 pending determination of whether the order for relief should be entered.

77 Jurisdiction is vested in the District Court under Title 28: sec. 334.

78 *In re Sherman*, 491 F. 3d 948, Bankr. L. Rep. (CCH) P 80969 (9th Cir. 2007); S. Rep. No. 95-989 at 54-55 (1978); House Report 1977 No 95-595:340.

79 *Mann v Chase Manhattan Mortg*. Corp., 316 F. 3d 1, 3, 40 Bankr. Ct. Dec. (CRR) 189, 49 Collier Bankr. Cas. 2d (MB) 1715, Bankr. L. Rep. (CCH) P 78787 (1st Cir. 2003; *In re Computer Communications, Inc*., 824 F. 2d 725, 16 Bankr. Ct. Dec. (CRR) 615, 17 Collier Bankr. Cas. 2d (MB) 556, Bankr. L. Rep. (CCH) P 71933 (9th Cir. 1987): "Congress designed the [automatic stay] to protect debtors and creditors from piecemeal dismemberment of the debtor's estate."

80 *Bankruptcy Code* 1978:sec. 362(1): "The commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title; (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title; (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate; (4) any act to create, perfect, or enforce any lien against property of the estate; (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title; (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title; (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and (8) the commencement or continuation of a proceeding before the United States Tax Court concerning a tax liability of a debtor that is a corporation for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title."

against the debtor's property; the collection or recovery of any claim that arose before the debtor commenced reorganisation; and setting off and the collection of any tax liabilities.[81] Essentially, the moratorium prohibits both personal and business creditors from initiating legal proceedings of any nature that could prejudice the success of the reorganisation.

The moratorium operates automatically, regardless of whether creditors or affected persons have been served with a notice of the bankruptcy case.[82] *In re Halas*,[83] the United States Bankruptcy Court, N.D. Illinois, Eastern Division, held that the automatic stay "is a self-executing provision of the Code and begins to operate nation-wide, without notice, once a debtor files a petition for relief."[84] Thus, although a notice of the bankruptcy petition is significant in determining whether to award damages or impose restrictions on the creditor for a violation of the moratorium, the moratorium is effective even if the creditor did not receive the notice of the bankruptcy case.[85] The stay applies to all entities and natural persons. It means that even government units are enjoined from commencing any legal action against the debtor.[86]

The unique feature of the automatic stay in Chapter 13 is that it also protects codebtors, whether spouse or life partner. In terms of section 1301 of the *Bankruptcy Code*, a creditor may not act or commence or continue any civil action to enforce a debt from an individual who is jointly liable with the debtor.[87] The main purpose of the codebtor stay is to insulate the debtor from possible enforcement actions or legal proceedings against codebtors.[88] This stay only applies during the pendency of the Chapter 13 case and ceases when the case is closed, dismissed or converted to

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81 *Bankruptcy Code* 1978:sec. 362.

82 *Constitution Bank v Tubbs,* 68 F. 3d 685, 691, Bankr. L. Rep. (CCH) P 76677 (3d Cir. 1995) held that "[t]he stay is 'automatic' because it is triggered upon the filing of a bankruptcy petition regardless of whether the other parties to the stayed proceeding are aware that a petition has been filed". *Sunshine Development, Inc. v F.D.I.C.,* 33 F. 3d 106, 113, 25 Bankr. Ct. Dec. (CRR) 1629, Bankr. L. Rep. (CCH) P 76045 (1st Cir. 1994 emphasised that "[b]ecause the automatic stay is exactly what the name implies—'automatic'—it operates without the necessity for judicial intervention".

83 *In re Halas, United States Bankruptcy Court, N.D. Illinois, Eastern Division* 194 B.R. 605 (Bankr. N.D. Ill. 1996.

84 *In re Halas* 1996:611.

85 See, for instance, *In re Jones*, 63 F. 3d 411, 412 & n.3 (5th Cir. 1995*); Bronson v U.S*., 46 F. 3d 1573, Bankr. L. Rep. (CCH) P 76401, Unempl. Ins. Rep. (CCH) P 14349B, 75 A.F.T.R. 2d 95-668 (Fed. Cir. 1995).

86 *Bankruptcy Code* 1978:sec.101(15) defines *entity* as including "person, estate, trust, governmental unit, and U.S. Trustee"; sec. 101(41) defines *person* as including "an individual, partnership, and corporation".

87 *Bankruptcy Code* 1978:sec. 1301(a); see examples *Harris v Fort Oglethorpe State Bank*, 721 F. 2d 1052, 9 Collier Bankr. Cas. 2d (MB) 1016 (6th Cir. 1983*); In re Humphrey*, 310 B.R. 735 (Bankr. W.D. Mo. 2004).

88 House Report 1977:121-23.

Chapter 7 or Chapter 11.[89] Although the stays prohibit creditors from enforcing their rights against the codebtor, it does not affect the liability of the codebtor where the debt is partially paid after the reorganisation plan is implemented.[90] Furthermore, the statute of limitation only permits creditors to take action against the codebtor 30 days after receiving notice of termination of Chapter 13 proceedings.[91] During the subsistence of the moratorium, the debtor should prepare a business reorganisation plan and apply for confirmation.

3.3.1.3 Filing and confirmation requirements of a reorganisation plan

After filing the petition, the debtor is required to file a reorganisation proposal. A Chapter 13 plan is only binding on creditors after the court confirms such a plan.[92] The reorganisation plan's confirmation is regulated in terms of section 1325 of the *Bankruptcy Code* 1978. The debtor bears the burden to prove that all the requirements are satisfied.[93] However, this does not preclude the court from independently reviewing the plan. If the plan meets all the confirmation requirements, the court is directed to confirm the plan. This section determines which requirements should be met by a Chapter 13 reorganisation plan. The discussion below elaborates on the good faith and feasibility test. In addition to these tests, it also explains the treatment of both secured and unsecured creditors.

Good faith requirement

One of the Chapter 6 business rescue weaknesses is that if the procedure includes sole proprietorship, the process would be vulnerable to abuse. Any debtor in financial distress may apply for business rescue even if their business has no prospects of surviving. Chapter 13 of the *Bankruptcy Code* 1978 imposes a good faith requirement to address this problem.

A debtor's petition for reorganisation under Chapter 13 must meet the good faith requirement.[94] In section 1325(a)(3), a Chapter 13 plan will only be effective if it was

89 *Bankruptcy Code* 1978:sec. 1301(a)(2).

90 *In re Zersen*, 189 B.R. 732 (Bankr. W.D. Wis. 1995); *In re Harris*, 16 B.R. 371, 5 Collier Bankr. Cas. 2d (MB) 1262, Bankr. L. Rep. (CCH) P 68543 (Bankr. E.D. Tenn. 1982).

91 *Bankruptcy Code* 1978:sec. 108©(2).

92 *Bankruptcy Code* 1978:sec. 1327(a).

93 The trustee is allowed to object to the confirmation of the debtor's proposed plan.

94 *Bankruptcy Code* 1978:sec. 1325(a).

proposed in good faith and accepted by all creditors.[95] However, the *Bankruptcy Code* 1978 does not define the term *good faith*.[96] The meaning of the phrase can only be drawn from case law relat to Chapter 13. In *In re Waldebt relief ordern*,[97] the United States Court of Appeals, Eleventh Circuit, held that the section does not prescribe what constitutes "good faith" because Congress intended to allow courts to exercise their discretion to make such a determination considering the circumstances of the debtor. In *In re Lundahl*, the United States Bankruptcy Court held that the proper inquiry is whether the plan constitutes an abuse of the spirit and purpose of Chapter 13.[98] It appears that the critical question is whether the debtor wants to delay liquidation or is genuinely intending to repay the creditors.

The courts have developed the totality of the circumstances test.[99] According to this test, a court hearing an application for the confirmation of a reorganisation plan should take into consideration several factors, including the amount proposed as instalment payments and whether debtors have a substantial surplus from their income.[100]

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95 This provision has been part of Chapter 13 since its promulgation in 1978. The repealed statute, Chapter XII of the *Bankruptcy Act*, used the same language to require good faith as a fundamental condition for the confirmation of the reorganisation plan.

96 *In re Keach United States Bankruptcy Court, D. Rhode Island* September 22, 1998 225 B.R. 264: As the *Bankruptcy Code* does not define good faith, determinations are made on a case-by-case basis, using the ''totality of the circumstances'' standard.

97 *In re Waldebt relief ordern*, 785 F. 2d 936, 941, 14 Bankr. Ct. Dec. (CRR) 488, Bankr. L. Rep. (CCH) P 71069 (11th Cir. 1986). The *Bankruptcy Code* 1978 section 1325(a)(3) provides that the bankruptcy court may not confirm a Chapter 13 plan unless the "plan has been proposed in good faith and not by any means forbidden by law". Congress intended to provide bankruptcy courts with a discretionary means to preserve the bankruptcy process for its intended purpose, and thus, whenever a Chapter 13 petition appears to be tainted with a questionable purpose, it is incumbent upon the bankruptcy courts to examine and question the debtor's motives; if the court discovers unmistakable manifestations of bad faith, confirmation must be denied. Unmistakable manifestations of bad faith need not be based upon a finding of actual fraud, requiring proof of malice, scienter or an intent to defraud.

98 *In re Lundahl*, 307 B.R. 233 (Bankr. D. Utah 2003). Proper inquiry for court, in deciding whether Chapter 13 debtor has exhibited a lack of "good faith" in proposing a plan, so as to preclude confirmation thereof, is whether the plan constitutes an abuse of provisions, purpose or spirit of Chapter 13.

99 *In re Flygare v Boulden*, 709 F. 2d 1344, 10 Bankr. Ct. Dec. (CRR) 1044, 8 Collier Bankr. Cas. 2d (MB) 1027, Bankr. L. Rep. (CCH) P 69298 (10th Cir. 1983). "Factors relevant to determination of whether Chapter 13 plan has been proposed in good faith are amount of proposed payments and amount of debtor's surplus, debtor's employment history, ability to earn and likelihood of future increases in income, probable or expected duration of plan, accuracy of plan's statements of debts, expenses and percentage repayment of unsecured debt and whether any inaccuracies are attempt to mislead court, extent of preferential treatment between classes of creditors, extent to which secured claims are modified, type of debt sought to be discharged and whether any such debt is nondischargeable in Chapter 7, existence of special circumstances such as inordinate medical expenses, frequency with which debtor has sought relief under Bankruptcy Reform Act, motivation and sincerity of debtor in seeking Chapter 13 relief, and burden which plan's administration would place upon trustee."

100 *In re Kitchens*, 702 F. 2d 885, 888, 10 Bankr. Ct. Dec. (CRR) 812, 8 Collier Bankr. Cas. 2d (MB) 1022, Bankr. L. Rep. (CCH) P 69150 (11th Cir. 1983). Debtors appealed from a decision of the United States District Court for the Southern District of Georgia, Dudley H. Bowen, Jr., J., which vacated the bankruptcy court's confirmation of their Chapter 13 plan. "The Court of Appeals held that Bankruptcy Court erred in confirming debtors' Chapter 13 plan, in which debtors proposed to repay their unsecured creditors to extent of no more

Additionally, the court will also assess if there are inconsistencies in the plan's description of debts, expenses, and percentage payback of unsecured debt. In principle, Chapter 13 is premised on the debtor's sincere and honest efforts to repay all creditors.[101]

From the different factors that have been accepted by courts to determine whether a debtor meets the good faith test, it is clear that the inquiry is intensively fact-specific. It depends on the circumstances of the debtor.[102] I believe that South Africa should consider the good faith test in its business rescue procedure for UBEs to shield the process from abuse and unscrupulous debtors who may want to delay liquidation proceedings.

Means and feasibility test

The proponent of a Chapter 13 plan should show that the debtor will be able to make substantial payments to the creditors. For this reason, the debtor's plan should meet the means or projected income test.[103] There are no hard and fast rules to govern this determination.[104] The only question before the court is whether, given the debtor's circumstances, the debtor will be able to pay all its creditors. The assessment of the feasibility of the debtor's plan depends on the debtor's means to fund its payments. Typical Chapter 13 debtors usually depend on their salaries, wages or income substitutes such as worker's compensation, unemployment benefits or social security.[105] However, where the debtor is involved in commercial activities, the business will be the main source of income. For example, a sole proprietorship *In re*

than 10% of their claims, without consideration of factors applicable to a determination of whether statutory requirement of good faith had been met."

101 *In re Ashton,* 63 B.R. 244 (Bankr. D.N.D. 1986).

102 *In re Pric*e, 366 B.R. 389, 396–397 (Bankr. M.D. Pa. 2007): "Demonstration of good faith or lack thereof is a fact intensive inquiry and does not lend itself to decision on summary judgment." *In re Fleury* United States Bankruptcy Court, D. Massachusetts, Eastern Division. June 6, 2003 294 B.R. 1: "In order to show cause why Chapter 13 case should not be dismissed as 'bad faith' filing, the Bankruptcy Court, William C. Hillman, J., held that debtor's conduct following closure of earlier Chapter 13 case, in dissipating more than $350,000 in less than 18 months without making any payment on her divorce-related debt to former husband, and in then filing second Chapter 13 petition, even though she had few debts other than her debt to ex-husband and little disposable income or remaining assets with which to fund plan, chiefly in attempt to avoid paying debt to her ex-husband, warranted conclusion that Chapter 13 petition was filed in 'bad faith' and supported dismissal with prejudice to debtor's ability to refile for 360 days."

103 *Bankruptcy Code* 1978:sec. 1325(a)(6).

104 *In re Hager*, 572 B.R. 848 (Bankr. W.D. Mich. 2017).

105 Gritsenko 2014:1262: "The 'means test' has the effect of forcing debtors from a Chapter 7 liquidation into a Chapter 13 reorganization if their income exceeds the given threshold."

Keach[106] submitted that its main source of income was the business. The debtor submitted that the success of its business depended on an increase in business revenue. The debtor could not substantiate its claims for increased revenue. Therefore, its application for confirmation was rejected.[107] Essentially, the debtor must be in a position to pay its creditors with the estimated disposable income. In *In re Flores*,[108] the Court of Appeals for the Ninth Circuit reversed its previous decision, ruling that a bankruptcy court may only confirm a Chapter 13 plan if its duration was at least as long as the statutory commitment period, even if the debtor had no foreseeable income for that period. It would indicate that the debtor's surplus income, if any, may be recorded and utilised under the plan during the five-year commitment period. In reaching this holding, the Court reversed its earlier ruling which suggested that projected disposable income would be considered once for the entire case.[109]

The main question is whether the debtor has a source of income and has sufficient funds to cover its living expenses and domestic obligations as they become due. The plan is not feasible if the debtor's budget does not reflect the amount necessary to cover living expenses.[110] However, the court may confirm a Chapter 13 plan if the debtor demonstrates that there are other sources of finances such as friends or relatives, tax refunds or sale of assets.[111]

The main advantage of Chapter 13 is that it allows the debtor to prove feasibility by averring that its business or assets will be refinanced. In this regard, the courts require the debtor to show that the refinance will take place as proposed. In making this

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106 *In re Keach*, 225 B.R. 264 (Bankr. D. R.I. 1998): To satisfy feasibility, a debtor's plan must have a reasonable likelihood of success, i.e., that it is likely that the debtor will have the necessary resources to make all payments as directed by the plan. The debtor carries the initial burden of showing that the plan is feasible.

107 *In re Keach* 1988:269. *In re McFashion*, 2014 WL 3015659 (Bankr. N.D. Ga. 2014).

108 *In re Flores*, 735 F. 3d 855, 70 Collier Bankr. Cas. 2d (MB) 499, Bankr. L. Rep. (CCH) P 82551 (9th Cir. 2013). "Chapter 13 trustee objected to confirmation of proposed three-year plan of debtors with above-median income, contending that a five-year plan was required. The United States Bankruptcy Court for the Central District of California, Meredith A. Jury, J. sustained objection and confirmed 60-month plan. Debtors appealed, and plan duration issue was certified for direct appeal. The Court of Appeals held that a bankruptcy court may confirm a Chapter 13 plan only if the plan's duration is at least as long as the applicable commitment period, even if the debtor has no projected income."

109 *In re Kagenveama*, 541 F. 3d 868, 59 Collier Bankr. Cas. 2d (MB) 1677 (9th Cir. 2008) which was overruled by *In re Flores*, 2013:499.

110 *In re Schweighart*, 2015 WL 7753408 (Bankr. C.D. Ill. 2015*); In re Lundahl*, 307 B.R. 233 (Bankr. D. Utah 2003).

111 *Brown v Gorman,* 2017 WL 4544672 (E.D. Va. 2017), aff'd, 726 Fed. Appx. 193 (4th Cir. 2018): "Dismissal with prejudice affirmed where plan provided unspecified time to sell property in view of case eligibility, good faith, and feasibility issues."

determination, the court will consider the property's value whether the debtor's property is in a distressed or appreciating market. Alternatively, whether the debtor will qualify for a loan or a lending institute has expressed interests in the debtor's business.[112] On a similar note, where a debtor intends to sell its property to finance its plan, the court will assess the likelihood of the debtor's property being sold at a market value or if the amount projected will be enough to pay creditors as proposed in the plan.[113] The means and feasibility test are meant to protect the creditors and ensure that they receive a substantial return as compared to the amount they would receive had the debtor been placed in a Chapter 7 bankruptcy proceedings. I am of opinion that the means test is not difficult to show when the debtor has a viable business that has a healthy cash flow. However, it may be challenging to demonstrate feasibility because businesses are prone to fail. Therefore, the likelihood of success should be calculated based on the current business assets and not the future fortunes of the business.

Treatment of secured creditors

Chapter 13 provides for two categories of creditors. Instead of classifying creditors as personal and business debtors, the Code categorises creditors as secured or unsecured creditors. Consequently, it ensures the equal treatment of creditors even though the debts may have arisen from either business or consumer expenditures.

There are three ways of dealing with a secured claim in Chapter 13.[114] The first option is to negotiate with the creditor. The second option provides for the surrender of the

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112 *In re Olsen*, 604 B.R. 790, 67 Bankr. Ct. Dec. (CRR) 144 (Bankr. W.D. Wis. 2019): The debtor, who had no unsecured or priority debt and whose only debt in default was balloon payment, owed to bank arising from his guarantee of commercial loan, sought confirmation of amended Chapter 13 plan which proposed, *inter alia*, equal monthly payments on loan for 60 months followed by a refinance and balloon payment. The bank objected. Holdings: The Bankruptcy Court, J, Furary held that the plan was feasible; the plan's treatment was a permissible modification under the Bankruptcy Code's anti-modification provision; under the unique facts of this case, the plan's treatment, including its provision of a balloon payment, was a permissible modification under the subsection of the Code requiring that a Chapter 13 debtor make periodic payments in "equal monthly amounts"; even if the Code's "equal monthly amounts" requirement prohibited the proposed balloon payment, the bank was equitably estopped from objecting to the plan under Wisconsin law; and an alternative equitable remedy would have been to reform the renewal note to match the terms of the original note. Objection was overruled and the plan was confirmed.

113 A good example would be *In re Dunn*, 399 B.R. 909 (Bankr. W.D. Wash. 2009). Bank filed a motion for adequate protection and objected to confirmation of debtors' second amended Chapter 13 plan, which, *inter alia*, proposed to sell the subject's real property. The Bankruptcy Court, J Brandt, held that the plan did not impermissibly modify the rights of the bank as a creditor whose only security was an interest in the debtors' residential real property.

114 *Bankruptcy Code* 1978:sec. 506.

encumbered property to the secured creditor. The third alternative allows the debtor to make payment of the claim in one of two general ways.

a. Negotiate with the secured creditor

A debtor in Chapter 13 may negotiate with a secured creditor on its secured claim.[115] In such a situation, acceptance of the plan by a secured creditor may remove judicial scrutiny unless the concerned agreement is not fair to other secured creditors. The Bankruptcy Rules have no provisions or methods for a secured creditor to accept a Chapter 13 proposal.[116] If a secured creditor objects to the proposed plan, it is deemed rejected. Should the secured creditor consent to the proposal, it is deemed to be accepted. However, uncertainty exists when the secured creditor neither objects nor accepts the plan. The problem arises in one of two scenarios:

First, if the debtor's suggestion is impermissible, the Chapter 13 trustee may object to confirming the plan.[117] The court may also reject the confirmation of such a plan because it cannot condone without the creditor's consent a plan that is in itself impermissible.[118] In such an instance, courts have treated the secured creditor's failure to consent or object as acceptance of the debtor's plan.[119] *In re Montesano*,[120] Colton J decided not to address the issue of balloon payments or equal monthly payments because the creditor's reluctance to object to confirmation was considered as acceptance.

Second, the affected creditor may raise objections when the court confirms the debtor's plan, but if such plan contravenes section 1325(a)(5), then the bankruptcy

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115 *Bankruptcy Code* 1978:sec. 1325(a)(5)(A). See also: *In re Chavez*, United States Bankruptcy Court, D. New Mexico. April 15, 1992, 138 B.R. 97926 Collier Bankr. Cas. 2d 1192 Bankr. L. Rep. P 74,595. The court held that creditors can consent to any Chapter 13 plan, even when the plan modifies creditor's rights. The court further held that in a nonconsensual situation of cram-down under a Chapter 13 plan, the focus of the court should not shift back to what the plan *may* provide, but rather focus should remain with what *must* be complied with for the plan to be confirmed, in other words, lien must be retained, and present value must be given.

116 *Bankruptcy Rule* 2015. Rule 3015 sets out procedures with regard to the filing of a plan and objections to it but does not address its acceptance. Rule 3018 also deals with the filing of an acceptance or rejection of a plan in Chapters 7 and 11 cases, but does not apply to Chapter 13 cases.

117 Drake ***et al*** 2019:5.8. The Bankruptcy Code 1978 does not define the meaning of the term *impermissible*. However, the term is used to indicate that an agreement between the debtor and creditors is prohibited in terms of the Code.

118 Dreher *et al* 2013:39.

119 *In re Flynn*, 402 B.R. 437, 445, Bankr. L. Rep. (CCH) P 81450 (B.A.P. 1st Cir. 2009). If the mortgagee failed to timely object to confirmation after receiving adequate and proper notice and adequate and proper service, then it is deemed to have impliedly accepted the Chapter 13 plan for purposes of section 1325(a)(5)(A), and the failure to comply with the provisions of section 1325(a)(5)(B) would not be grounds to deny confirmation.

120 *In re Montesano*, 2020 WL 5743104 (Bankr. M.D. Fla. 2020).

courts have ruled that failure to object to the confirmation of a plan constitutes acceptance.[121] However, this view is contrary to findings in other courts. Other courts have ruled that where a creditor has neither consented nor objected to the debtor's plan, the treatment of the secured claim should be dealt with in other procedures such as the elimination of a secured claim.[122] The implicit holdings of these cases are that the creditor's silence should not be understood as acceptance.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 added the "handing paragraph".[123] The provision prohibits the bifurcation of specific secured claims. Bifurcation is a process under section 506 of the *Bankruptcy Code* 1978 that divides a creditor's claim into secured and unsecured claims.[124] The value of the collateral property determines the secured component of the claim. Courts have held that the silence or absence of the creditor's objections to confirming a plan that bifurcates a secured claim in violation of the handing paragraph does not constitute an acceptance.[125] Furthermore, such a plan cannot be confirmed without the

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121 *In re Pardee*, 218 B.R. 916 (B.A.P. 9th Cir. 1998), aff'd, 193 F. 3d 1083, Bankr. L. Rep. (CCH) P 78022 (9th Cir. 1999); *In re Bolden*, 2013 WL 3897048 (E.D. Mich. 2013): In this case, the debtor's plan made clear that Bolden's auto loan would be "modified"; this modification reduced both the principal and the interest rate. The proposal said that Bolden would pay $10,000 – the fair market value of the car at the time – at a lower interest rate of 7.5%, over a period of thirty-eight months, making her total payments to Capital One $17,468.87. This was slightly above the principal amount due. The plan also said that there were no unsecured creditors and all unsecured claims would be considered paid. Bolden was required to complete the overall plan, repaying all creditors within 48 months. Capital One did not object to either the reduced principal or interest rate under the Plan. On 20 April 2007, the Bankruptcy Court confirmed the proposed plan. Bolden made all payments as agreed; the modified auto loan was paid in full in 2010. The bankruptcy trustee sent notice to all creditors saying that Bolden completed the plan. On 12 May 2012, Bolden filed a Motion to Reopen her Chapter 13 case and a Motion to Release Lien of Capital One Auto Finance and to Bar Further Collection. The Bankruptcy Court held a hearing. Bolden argued that she was entitled to a discharge, not by grant of statute, but because the plan says that her loan was modified, and thus, paid in full. On 24 August 2012, the Bankruptcy Court granted both motions. Capital One now appealed. The appeal was dismissed because section 1327(a) of the Bankruptcy Code states that the "provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted or has rejected the plan."

122 *Wright v Commercial Credit Corp*., 178 B.R. 703 (E.D. Va. 1995): The creditor that had been granted lien against property that Chapter 13 debtors used as their principal residence, objected to confirmation of the debtors' proposed plan, on the ground that the plan impermissibly sought to modify its rights. The Bankruptcy Court entered order denying confirmation, and the debtors appealed. In the District Court, Doumar J held that "notice provided by debtors' proposed Chapter 13 plan, that debtors would seek valuation of creditor's collateral and determination that creditor's claim was wholly unsecured, was not sufficient to satisfy creditor's due process rights, but prohibition against lien stripping would not apply to the extent that it was determined, in adversary proceeding, that creditor's claim was wholly unsecured". See also *Cen-Pen Corp. v Hanson*, 58 F. 3d 89, 92, 33 Collier Bankr. Cas. 2d (MB) 1159, Bankr. L. Rep. (CCH) P 76549 (4th Cir. 1995).

123 *Bankruptcy Code* 1978:sec. 1325(a)(5): The court shall confirm a plan if, with respect to each allowed secured claim provided for by the plan, the holder of such claim has accepted the plan.

124 *Bankruptcy Code* 1978:sec. 506.

125 *In re Montoya*, 341 B.R. 41, 55 Collier Bankr. Cas. 2d (MB) 1846, Bankr. L. Rep. (CCH) P 80503 (Bankr. D. Utah 2006): A hearing was held on confirmation of the debtor's proposed Chapter 13 plan. The Bankruptcy Court, Boulden J held that provision of the Bankruptcy Abuse Prevention and Consumer Protection Act (2005) prevented bifurcation and "cramdown"; the lender's failure to object to proposed Chapter 13 plan that

affirmative action of the secured creditor.[126] Bifurcation of secured claims creates two different hearings that may be expensive for sole proprietorships that are already in financial distress.

It seems the best way of solving a plan, which was confirmed without the consent of a secured creditor, should be dealt with under the finality principle.[127] The finality principle provides that failure to object does not constitute acceptance. Therefore, the court makes the final decision dealing with an improper plan. A good example is *In re Shultz*[128] where the Bankruptcy Court ruled that if a plan violates the equal monthly payment rule provided in section 1325, such a plan is confirmable in the absence of objections by the creditor. The creditor is deemed to have accepted the plan.

b. Surrender of encumbered property

A debtor may propose to surrender an encumbered property as provided in section 1325(a)(5)(C).[129] This provision states that a plan properly treats a secured claim if the debtor undertakes to surrender the encumbered property to the holder of the claim.[130] Upon surrender, the creditor may decide to enforce its remedies and subject the encumbered property to its claim. However, the encumbered property remains the estate's property until the plan is confirmed, and the automatic stay continues to apply. The debtor's proposal to surrender its property effectively demonstrates that it is not required for the debtor's reorganisation.[131] As a result, if the encumbered property has no equity, such a provision can be used to lift the stay under section 362(d)(2).

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improperly bifurcated its claim could not be deemed an implied acceptance thereof; and the court could not confirm the plan which, in proposing to bifurcate lender's claim, violated provision of the Bankruptcy Abuse Prevention and Consumer Protection Act, 2005. See also *In re Bethoney*, 384 B.R. 24, 59 Collier Bankr. Cas. 2d (MB) 40 (Bankr. *D. Mass. 2008); In re Allen,* 360 B.R. 216 (Bankr. E.D. Tex. 2006)*; and In re Montgomery*, 341 B.R. 843 (Bankr. E.D. Ky. 2006).

126 *In re Bethoney*, 384 B.R. 24, 59 Collier Bankr. Cas. 2d (MB) 40 (Bankr. D. Mass. 2008).

127 *Bankruptcy Code* 1978:sec. 1327(a).

128 *In re Schultz*, 363 B.R. 902, 57 Collier Bankr. Cas. 2d (MB) 703 (Bankr. E.D. Wis. 2007). The Bankruptcy Court held that Chapter 13 debtor's failure to comply with statutory equal payment requirement did not prevent confirmation of his plan, where the secured creditor that was to receive unequal payments did not object to the plan.

129 *Bankuptcy Code* 1978:sec.1325(a)(5)(C): The court shall confirm a plan if the debtor surrenders the property securing such claim to such holder.

130 *Bankruptcy Code* 1978:sec. 362(a): Until the plan is confirmed, the encumbered property remains property of the estate to which the automatic stay continues to apply.

131 *In re White*, 487 F. 3d 199, 205, Bankr. L. Rep. (CCH) P 80909, 2007-1 U.S. Tax Cas. (CCH) P 50487, 99 A.F.T.R. 2d 2007-2395 (4th Cir. 2007): Motor vehicle lessor under lease assumed by Chapter 13 debtors moved for allowance of administrative expense claim after debtors allegedly breached their obligations under assumed lease by failing to pay for excess mileage and wear upon their surrender of vehicle. Trustee objected based on alleged lack of benefit to estate. In the Bankruptcy Court, Tucker J held that: "the language in

In a typical surrender scenario, the debtor will be in possession of the encumbered property, such as a vehicle or a home, which she desires to surrender. Surrender in these situations simply entails the debtor relinquishing the claimant's custody and control of the property.[132] In the context of immovable property such as a house, farm or business premises, the debtor is required to vacate the property.[133] When the debtor no longer possesses the property that must be relinquished, complications may arise. Such a situation may arise in various ways. For example, the item may have been given as a gift, or a debtor could have co-signed a loan secured by a car that was awarded to a spouse as part of a divorce settlement. It could have been stolen or simply lost.[134] As long as there is no proof of fraud, bad faith, or wrongdoing on the part of the debtor, the inability to properly convey the encumbered property will not prohibit surrender as envisaged by the *Bankruptcy Code*.[135] *In re Boley*,[136] the Bankruptcy Court held that surrendering of property in this context does not require delivery of the property to the creditors. Instead, the word *surrender* should be construed to mean relinquishing of all rights, including possessory rights.[137]

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debtors' confirmed Chapter 13 plan, that placed claim held by lessor under debtors' assumed motor vehicle lease, not in class of administrative expense claims, which was limited solely to fee claims of trustee and of debtor's attorney, but in separate class reserved for executory contracts and unexpired leases which debtors had assumed and on which they were to continue making their regular monthly payments, was *res judicata* on treatment of motor vehicle lessor's claim and prevented it from asserting administrative expense claim; and even if lessor's motion could be construed as motion to modify plan, reclassification of lender's claim was not permissible use of post-confirmation motion to modify."

132 *In re Main*, 2019 WL 325805 (Bankr. N.D. Okla. 2019). Although the term *surrender* is not defined in the Bankruptcy Code, its general meaning is not obscure. The operative phrase in section 1325(a)(5)(C), "surrenders the property securing such claim to such holder" makes it abundantly clear that the term *surrender* refers to the secured creditor eventually holding all rights, including the right of possession, in the property securing the claim. Thus, a well-known bankruptcy treatise defines *surrender* in the context of section 1325(a) as the "renunciation of any rights in the collateral", including the right to possess the collateral.

133 *In re Williams*, 70 B.R. 441 (Bankr. D. Colo. 1987): On the motion to vacate order confirming the Chapter 13 plan, the Bankruptcy Court, Brumbaugh, J., held that a Chapter 13 debtor, who claimed to have abandoned interest in property subject to security interest, but who failed to vacate the residence and property, did not "abandon" her interest, thus requiring an order confirming the debtor's Chapter 13 plan to be vacated, where the plan provided that the debtor was abandoning interest in the residence.

134 *In re Walton*, 243 B.R. 793 (Bankr. M.D. Ala. 1999), a Chapter 13 debtor sought to modify his unconfirmed plan, after the vehicle, which secured his indebtedness to the creditor, was reported stolen, in order to provide for surrender of the vehicle and for payment of any deficiency claim asserted by the creditor as a mere general unsecured claim. The creditor objected. The Bankruptcy Court, Rodney R. Steele, Chief Judge, held that the debtor could amend the plan, before it was confirmed, to provide for surrendering the vehicle.

135 *In re Alexander*, 225 B.R. 665 (Bankr. E.D. Ark. 1998): The creditor whose claim was secured by interest in a truck with which the debtor's husband had absconded, objected to provision in debtor's proposed Chapter 13 plan, wherein the debtor proposed to surrender her interest in the truck and treated the creditor as unsecured. The Bankruptcy Court Scott, J., held that absent of any evidence of fraud or bad faith on the debtor's part, she could surrender her interest in the truck and treat the creditor as unsecured, without the necessity of physically driving the truck to the creditor's place of business and delivering the truck into the creditor's possession.

136 *In re Boley*, 2016 WL 155700 (Bankr. M.D. Ala. 2016).

137 *In re Boley* 2016 155700; *In re White*, 487 F. 3d 199, 205 (4th Cir. 2007).

However, some courts have rejected to permit the surrender of encumbered property to a holder of a claim where the debtor does not have the property.[138] *In re Higley*,[139] the court held that the debtor who reported the vehicle missing had not effectively delivered the property to the creditor. Similarly, some courts have stated that consent is required for the debtor to surrender the property.[140] Such a requirement has been held to be contradicting the very purpose of allowing debtors to surrender the encumbered property to the creditor. I am of the view that the surrender of property is not meant to benefit the debtor but the creditor. If the creditor cannot exercise his rights on the property, then the idea of collateral would not serve any purpose. Furthermore, if the property is of no value at the time of surrender, the claimant should not be treated as a secured creditor.

c. Modification and cram-down of secured claims

A debtor may propose modifying the secured creditor's claim in section 1322(b) of the *Bankruptcy Code*. The Code provides that a Chapter 13 plan may change the holders' rights of secured claims, other than a claim secured by a security interest in real property that is the debtor's principal place of residence.[141] There are no limits stipulated in the Code. Modification can be done through acceptance by the creditor or surrender by the debtor. These concepts have been discussed above. The third alternative is the cram-down provided in section 1325(a)(B) of the Code.

The cramdown treatment of secured creditors lays out the requirements for a plan's approval if the debtor wants to keep an encumbered property and proposes to modify the secured creditor's rights.[142] However, the creditor refuses to accept it. For a cramdown to be valid and enforceable under section 1325(a)(5)(B)(ii), three requirements must be met. First, the plan must provide for the creditor to retain its lien

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138 *In re Mustafa*, 557 B.R. 533 (Bankr. E.D. Ky. 2016); *In re Smith*, 207 B.R. 26 (Bankr. N.D. Ga. 1997); *In re Robertson*, 72 B.R. 2 (Bankr. D. Colo. 1985); *In re McCann*, 537 B.R. 172 (Bankr. S.D. N.Y. 2015). The court held that the debtor did not "surrender" th vehicle when she left it at a third-party storage service that charged a storage fee.

139 *In re Higley*, 539 B.R. 445 (Bankr. D. Vt. 2015).

140 *In re Service*, 155 B.R. 512 (Bankr. E.D. Mo. 1993): Chapter 13 debtors sought reconsideration of the Bankruptcy Court's denial of their motion to compel the creditor to accept the collateral that debtors had surrendered under their plan to satisfy the secured claim. The Bankruptcy Court, Barry S. Schermer, Chief Judge, held that debtors could not compel the creditor to exercise its rights in the collateral, and debtors could not abandon the property to the creditor that had no possessory interest in it.

141 *Bankruptcy Code* 1978:sec.1322(b)(2).

142 Markell 1998:227 provided a detailed account of the cramdown and unfair treatment of creditors.

until the first payment of the debt is made.[143] Second, "the value, as of the effective date of the plan, of the property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim."[144] Third, the plan must propose the payment of the secured claim within the plan's term; the plan must not extend to more than five years.[145]

Regarding the first requirement, the plan must provide a secured claim holder with a lien until the debtor pays all the outstanding amounts. There are two subclauses of section 1325(a)(5)(B)(i). The first, subclause (B)(i)(I), stipulates that the reorganisation plan must provide for a holder of a secure claim to retain its lien until such a time that the debt is fully paid or if the debtor is discharged.[146] It appears that this provision guarantees that the lien remains effective against the secured claim until the debtor has completed payments. The second subclause (B)(i)(II) provides what should happen where the Chapter 13 case has been conversed or dismissed before the debtor completes payment. The secured creditor retains its lien but only to the extent permitted by non-bankruptcy laws.

The second requirement stipulates that if the debtor's plan modifies a secured claim, the creditor should receive property with a value as of the effective day of the plan.[147] It means that the amount received should not be less than the allowed amount of the claim. The statute incorporates two different valuation concepts. First, the value of the encumbered property determines the amount of the allowed secured claim under the bifurcation principle of *Bankruptcy Code* section 506(a).[148] Second, the requirement for payment of the value of the allowed claim incorporates the concept of the time value of money.

The above-mentioned implies that when a Chapter 13 plan proposes the payment of a secured claim through future payments, the secured creditor must receive the present value of the claim. Although the amount required to adjust future payments to present value does not require interest payment, economic principles effectively

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143 *Bankruptcy Code* 1978:sec. 1325(a)(5)(B)(i), for a Chapter 11 cramdown and settlement see also Broude 1984:441-454; Burks 1991:1; Pachulski 1980:932-933.

144 *Bankruptcy Code* 1978:sec. 1325(a)(5)(B)(ii).

145 *Bankruptcy Code* 1978:sec. 1322(d).

146 *Bankruptcy Code* 1978:sec. 1325(a)(5)(B)(i)(I). See *In re Donnadio*, 608 B.R. 507 (B.A.P. 6th Cir. 2019), where the creditor with 910 vehicle claims objects to confirmation, the plan must include lien retention language.

147 *Bankruptcy Code* 1978:sec. 1325(a)(5)(B)(ii).

148 Dreher *et al* 2013:23.

equate the present value requirement with payment of interest. It is important to point out that the present value component of the total amount to be paid to the holder of the claim is known as the “plan interest” or “present value interest”. However, how to calculate the plan interest does not form part of this discussion. Nonetheless, it can be gathered from this discussion that the interests of both the creditor and that of the debtor seem to strike an acceptable balance. On the one hand, the debtor who intends to retain the collateral property stands to use the property to continue its business. On the other hand, the creditor benefits from the interest that accrues due to the present value interest.

Treatment of unsecured creditors

According to the Bankruptcy Rules, a debtor may submit a Chapter 13 plan in terms of the form provided at the district court.[149] However, the debtor should use a nonstandard provision when the proposed treatment of unsecured claims differs from the prescribed form.[150]

An unsecured claim refers to claims with no lien on any property owned by the debtor. Such a claim does not enjoy any priority over other claims such as medical bills or promissory notes. In terms of the bifurcation principle provided in section 506 of the *Bankruptcy Code*, “a secured creditor whose debt exceeds the value of property subject to its lien has an unsecured claim for the deficiency.”[151] On a similar note, a creditor with a lien that forms part of exempt property becomes an unsecured creditor to the extent that the lien is avoidable as a preferential or fraudulent transfer.

The *Bankruptcy Code* 1978 prescribes two alternatives for the treatment of unsecured creditors.[152] The Code allows the modification of the creditor’s rights by adjusting the maturity debt. However, the debt should be paid within the duration of the rescue procedure.[153] The second option in terms of section 1322(b)(2) of the Code states that a Chapter 13 plan may include a partial or complete debt write-off. When the debtor

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149 A debtor must use Official Form 113 for the reorganisation plan unless a district adopts a Local Form *Federal Rule Bankruptcy*: rule 3015.

150 *Bankruptcy Rules* 2015: rule 3015.

151 *Bankruptcy Code* 1978:sec. 506(a). *In re Tanner,* 217 F. 3d 1357, 36 Bankr. Ct. Dec. (CRR) 106, 44 Collier Bankr. Cas. 2d (MB) 760 (11th Cir. 2000); *In re Samala*, 295 B.R. 380, 50 Collier Bankr. Cas. 2d (MB) 801 (Bankr. D. N.M. 2003).

152 *Bankruptcy Code* 1978:sec. 1322(b).

153 *Bankruptcy Code* 1978:sec. 1322(b)(2).

has been discharged, the debtor is released from claims forming part of the plan. Although there are exceptions, it would be advisable for an unsecured creditor to negotiate a partial write-off.[154]

When a Chapter 13 plan provides a modification of the unsecured debts, it must meet the requirements for confirmation prescribed in section 1325 of the Code. When dealing with unsecured debts that have already become due, section 1322(b) permits the debtor to cure the default and maintain payments while its confirmation of Chapter 13 is in progress.[155] The alterations to the creditor's claims must meet the best interest of the creditor's test and also comply with the disposable income requirement.

The treatment of creditors is the most complicated aspect of business rescue, especially where the debtor is an unincorporated entity. The main creditor should not be allowed to compel a sole proprietor into accepting that there are no survival prospects. This view is based on the assumption that the main creditors of a sole proprietorship are banks or financial institutions. It is estimated that a third of South African entrepreneurs get their start-up businesses from banks, and use their homes as collateral.[156] The legislature should enact measures to protect sole proprietorships from the influence of creditors, especially secured creditors.

3.3.1.4 Discharge of a Chapter 13 debtor

The ultimate goals for reorganisation are to free the debtor from liability and ensure that creditors receive a substantial return.[157] Chapter 13 provides two avenues for the discharge of a sole proprietorship, namely full payment discharge and hardship discharge.[158] The following sections briefly explain these avenues.

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154 *Bankruptcy Code* 1978:sec. 1328(a).

155 *Bankruptcy Code* 1978:sec. 1322(b)(5).

156 Mazanai & Fatoki 2011:208-216.

157 The Consumer Project of 2017 reveals that many debtors under Chapter 13 fail to discharge their obligations due to exorbitant attorney fees. It may cost a debtor $3,200 to file a Chapter 13 case. Furthermore, Eraslan *et al* 2017:673 posited that the failures of Chapter 13 are mainly caused by stringent confirmation requirements. For instance, a Chapter 13 case may be dismissed for failing to meet the "steady income test". In sight of these demerits, it seems that a debtor under Chapter 13 debtor should be involved in some form of business to manage the cost of proceedings and guarantee a substantial implementation of the reorganisation plan.

158 *Bankruptcy Code* 1978:sec. 1328

Full payment discharge

Full payment discharge is also known as the completion. When a debtor completes payments under the plan, either as originally confirmed or modified during reorganisation, the debtor receives a discharge in section 1328 of the *Bankruptcy Code*. It is important to note that a debtor does not have to pay debts in full to receive a section 1328(a) discharge. Rather, it applies when the debtor has completed all of the dischargeable debts as required by the confirmed or modified plan.[159]

Hardship discharge

Hardship discharge happens when the debtor fails to complete payments due to unforeseen circumstances beyond its control.[160] The *Bankruptcy Code* 1978 only permits the grant of a discharge if modification of the plan under section 1329 is not practicable and if unsecured creditors have received distributions under the plan that are not less than they would have received in a Chapter 7 case.[161] The idea in section 1329 of the *Bankruptcy Code* 1978 is that where debtors can no longer make payments because of economic recession or loss of property in a storm or fire, the bankruptcy system should not accelerate their downfall. Instead, it should provide a springboard to business recovery by freeing their estate from liability. The main problem faced by sole proprietorships is that they have business debts and personal debts. Chapter 13 discharge provisions are a library of lessons for any legislature contemplating promulgating a rescue procedure for sole proprietorships. The following section explores the Chapter 11 provisions applicable to partnerships.

3.3.2 Chapter 11 reorganisation process for partnerships

A partnership in financial distress may be reorganised back to profitability in terms of Chapter 11.[162] The following sections discuss the different rescue process stages that apply to partnerships beginning with the commencement process.

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159 *In re Moore*, 602 B.R. 40 (Bankr. E.D. Tenn. 2019). While a confirmed Chapter 13 plan's treatment of debtor's domestic support obligations is *res judicata* on how the obligation will be paid under plan, any amount not paid, plus interest accruing under nonbankruptcy law, remains a nondischargeable debt, and debtor is not absolved of his duty to pay this balance in full once the bankruptcy case is over.

160 *Bankruptcy Code* 1978:sec. 1328(b).

161 *Bankruptcy Code* 1978:sec. 1328(b).

162 Flynn 2018:44 observed that the size of the partnership's assets determines the outcomes of each case. A debtor who has assets amounting to 10 million in value has a 40 per cent chance of successfully implementing a rescue plan. However, debtors with more than 100 million in assets have a 60 per cent chance to survive

3.3.2.1 Commencement procedure for partnerships

The proper venue for lodging an application for business reorganisation in Chapter 11 is the district court where the partnership operates its business. The debtor or creditor may file such a petition on a voluntary or involuntary basis.

a. Voluntary commencement

A voluntary petition can be filed on behalf of a partnership by one or more general partners.[163] As a general rule, all partners must consent to a voluntary petition by the partnership.[164] In *Goldberg v Rose,*[165] the United States Bankruptcy Appellate Panel of the Ninth Circuit Court dismissed a bankruptcy petition filed by one partner without the consent of the other three partners. Jones J held that "although a general partner may ordinarily bind a partnership without the consent of the other general partners, in bankruptcy, this rule is reversed". If there are nonconsenting partners, the voluntary petition is considered an involuntary petition and must comply with the prescribed procedural requirement.[166] It prevents nonconsenting partners from being subjected to business reorganisation proceedings without allowing them to consent or object.[167] The *Bankruptcy Rules* 1010 states that a partner who files a voluntary petition must inform the non-filing partner that a petition has been filed. If non-filing partners oppose the petition, they must file their notice of opposition within 20 days.[168]

Chapter 11 reorganisation. Generally, it seems that debtors heavily depend on Chapter 11 regardless of the size, legal form or commercial activities. The number of debtors applying for this procedure seems to increase every year. It is further projected that after COVID-19, the majority of debtors will be in financial distress, and many will seek relief under Chapter 11. Flynn 2018:44; see also Howard ***et al*** 2017:61.

163 *Bankruptcy Rules* 2015: rule 1004(a).

164 *Bankruptcy Rules* 2015: rule 1004(a); *In re Seychelle*s, 30 B.R. 72, 74 (Bankr. N.D. Tex. 1982): A partnership reorganisation case was commenced by filing of involuntary petition by two of 14 general partners. The owner of the debtor partnership purporting to act as managing general partner filed a conversion of case to Chapter 11. The petitioning partner filed a motion to quash conversion. Ford J held that general partners had acted involuntarily to convert a case without notice and hearing, and a fact that the partner seeking conversion was a managing partner of the debtor, did not change the requirement that either all general partners must affirmatively consent, or conversion must be after notice and hearing.

165 *Goldberg v Rose (In re Cloverleaf Properties)* 78 B.R 242, 245 (Bankr. 9th Circuit 1987).

166 *Bankruptcy Code* 1978:sec. 303(b)(3)(A).

167 *In re Alpine Lumber and Nursery*, 13 B.R. 977, 979 (Bankr. S.D. Cal. 1981): The debtor, after filing a voluntary conversion of involuntary proceeding to Chapter 11, sought order for possession of property. The Bankruptcy Court, Katz, J., held that a voluntary request for entry of a Chapter 11 order for relief does not convert an involuntary case so as to entitle the debtor to removal of the interim trustee, appointed for cause, from possession of the debtor's estate.

168 *Bankruptcy Rules* 2015: rules 1010, 1011 and 7004(a) and (b); Official Form 13.

In re SWG Assocs,[169] the Bankruptcy Court W.D. Pennsylvania had to determine whether a petition for business reorganisation under Chapter 11 filed without the consent of a general partner, was properly filed. The partnership agreement stated that "[a] majority of the managing partners … [need] to determine all questions relating to the conduct and management of the partnership business". Four general partners formed the partnership. Three of the partners decided to apply for business reorganisation without the knowledge and consent of the fourth partner. The legal question was whether business reorganisation under Chapter 11 forms part of partnership business transactions? The court held that filing a bankruptcy petition is an act that most certainly could make the future ordinary business of a partnership debtor impossible.[170] Thus, all partners were required to consent. The court did not dismiss the petition. Instead, it treated it as an involuntary petition.[171] It meant that the partners had to serve the non-consenting partner in line with *Bankruptcy Rules* 1010. If one of the partners does not require consent, the petition is considered an involuntary petition.

The approach is different when dealing with LLPs. *In re Bel-Air Association Ltd,*[172] the United States Bankruptcy Court, W.D. Oklahoma held that a general partner could unilaterally file for business reorganisation despite objections from limited partners. The LLP consisted of one general partner and three limited partners. The general partner filed a voluntary petition for reorganisation on behalf of the partnership. It was followed by the filing of a business reorganisation plan. A limited partner opposed the approval of the reorganisation plan. He argued that the general partner was self-dealing and had breached his fiduciary duty. Hence, an examiner was supposed to be appointed to investigate these allegations. Berry J held that the petition was duly filed by the only general partner in compliance with the rules of the bankruptcy procedure. The court further held that the alleged filing of the petition without the knowledge and consent of the limited partner did not breach any laws under Oklahoma's *Uniform Limited Partnership Act*. Furthermore, the issues of self-dealing and breach of fiduciary duty were not supported with sufficient evidence to warrant the appointment of an examiner. I am of the view that if an assessment of the partnership's claims against

169 *In re SWG Assocs* 199 B.R 557 (Bankr. W.D. Pa. 1996):
170 *Bankruptcy Procedure* 2015: rule 1004(a).
171 *Bankruptcy Code* 1978:sec. 303(b)(3)(A).
172 *In re Bel Air Association* Ltd 4 BR168, 171 (Bankr W.D Okla 1980).

its partners indicates that the business is on the brink of bankruptcy, a voluntary commencement of business reorganisation becomes necessary.

b. Involuntary commencement

In terms of section 303(b)(1) and (2) of the *Bankruptcy Code*, partnership creditors may file for the involuntary business reorganisation of a partnership. Individual creditors of partners do not qualify as petitioning creditors against the partnership. [173] However, it appears that a general or a limited partner who has a creditor's claim against the partnership may be a petitioning creditor under section 303(b)(1).[174] In *In re Taylor & Associates,*[175] the limited partners were persuaded to invest in the partnership with promises of high returns on purchasing bonds, stocks and stock options. However, the proposed returns were never achieved, and the investment was converted into a loan for the partnership.[176] The court ruled that the limited liability partners were creditors that had delictual or contractual claims against the limited partnership under such circumstances.[177]

A general partner of a dissolved partnership has legal standing to file a Chapter 11 petition for the partnership.[178] In *In re Pallet Reefer Co*,[179] the United States Bankruptcy Court, E.D. Louisiana, held that even if the general partner has lost the right to manage the partnership, section 303(b)(3)(A) empowers the general partner to file a petition under Chapter 11 or 7. Nonetheless, a general partner who transfers his interests to a third party is not qualified to initiate Chapter 11 proceedings. The third party is also not eligible to commence the reorganisation proceeding.

In re Tip O Texas RV Village,[180] Comer, a general partner in an LLP, assigned his interests to a corporation. Then Comer and the corporation applied for an involuntary petition against the limited partnership. The United States Bankruptcy Court, M.D. Florida, Tampa Division, ruled that neither Comer nor the corporation had authority

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173 House Report 1978:197.
174 *Bankruptcy Code* 1978:sec. 303(b)(1).
175 *In re Taylor & Associates L.P* 193 B.R 465 (Bankr. E.D. Tenn. 1996).
176 *In re Taylor & Associates L.P* 1996: 472.
177 *In re Taylor & Associates L.P* 1996:472.
178 *Bankruptcy Code* 1978:sec. 303(b)(3).
179 *In re Pallet Reefer Co*. 233 B.R 68, 692 (Bankr. La 1999).
180 *In re Tip O Texas RV Village*, 87 B.R 195 (Bankr. M.D 1989).

under Florida law to apply for an involuntary petition against the partnership.[181] Section 702 of the Revised Uniform Limited Partnership Act states that the assignee of a general partner's interests in a limited partnership does not have legal standing to exercise the rights of a partner.[182] Furthermore, the assignor ceases to be a partner and no longer has the powers and privileges of a partner.[183]

It is interesting to note that partnerships, unlike sole proprietorships, can be subject to compulsory business reorganisation without committing peonage. I believe that peonage only recognises natural persons as victims. While partnerships are recognised as associations of individuals, the *Bankruptcy Code* 1978 treats them as legal entities for bankruptcy purposes. As a result, partners in a partnership may be compelled to consider business reorganisation.

3.3.2.2 Moratorium applicable to partnerships

When a partnership files a petition for reorganisation under Chapter 11, any legal proceedings against the partnership automatically stay.[184] The stay protects the partnership and its estate but does not prohibit creditors from commencing legal proceedings against partners or guarantors.[185]

In *Teachers Ins & Annuity Ass'n v Butter,*[186] the United States Court of Appeals, Second Circuit, held that when creditors sue partners for partnership debt, section 362(a) does not protect general partners. Furthermore, the bankruptcy court has no jurisdiction to extend the moratorium to partners.[187] However, section 105 of the

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181 *In re Tip O Texas RV Village* 1989:195.

182 *Revised Uniform Limited Partnership Act* 1976:sec. 702. This Act has been adopted in 49 states. It was also enacted in Colorado, Georgia, Minnesota, New York and Oklahoma.

183 *Revised Uniform Limited Partnership Act* 1976:sec. 702.

184 *Bankruptcy Code* 1978:sec. 362(a)(1) stays an "action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case".

185 *Patton v Bearden* 8 F. 3d 343 (6th Cir 1993) The District Court concluded that the Beardens were not protected by the automatic stay of claims against the debtor–partnership (partner). They concurred that the mere fact that defendants were general partners did not entitle them to protection under the debtor–automatic partnership's stay. The court cited *In re Bank Center Ltd*, 15 B.R 64 (Bank. W.D. Penn. 1981), wherein it was held that an automatic stay provisions of the *Bankruptcy Code* does not apply to actions against general partners of debtor limited partnership.

186 *Teachers Ins & Annuity Ass'n v Butter* 803 F. 2d 61, 65 (2d Circ 1986).

187 *In re Veeco Inv. Co. L.P* United States Bankruptcy Court, E.D. Missouri, Eastern Division, 29 July 1993 157 B.R. 45. In similar circumstances, the Bankruptcy Court, in Missouri, Eastern Division ruled that "guarantors of debtor's obligation to creditor were not protected by the automatic stay, as guarantors, and use of bankruptcy court's equitable powers to enjoin creditor from proceeding against guarantors on guarantees was also not warranted".

Bankruptcy Code 1978 empowers the court to grant a temporal injunction prohibiting creditors from commencing legal proceedings against partners and guarantors.[188] Numerous cases have recognised the propriety of issuing such an injunction during a pending partnership case.[189] For instance, *In re Litchfield Co. Ltd. Partnership,*[190] the Bankruptcy Court held that in certain circumstances, creditors may be barred from bringing a lawsuit against an individual partner of an insolvent partnership in order to protect the estate of the debtor.

When issuing an injunction, the court is required to evaluate if the applicant approaches the court in good faith and whether the pending legal proceedings will negatively affect the success of reorganisation. For instance, in *Chase Manhattan Bank v Third Eighty-Nine Assocs,*[191] the partner pledged its assets to finance the reorganisation of the partnership. However, the partner's creditors commenced enforcement action against the partner. The Bankruptcy Court granted an injunction against the partner's creditors, reasoning that the action would prevent the non-debtor party from injecting finances into the reorganisation. The action would thus disrupt the attempt to reorganise the partnership. The court further held that claims against the non-debtor party are treated as claims against the debtor (partnership).[192]

In *Machlett Laboratories, Inc. v Techny Industries*,[193] the United States Bankruptcy Court provided four factors that must be considered before an injunction is issued against creditors claiming a partnership debt: The petitioner must show that it is likely

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188 *Bankruptcy Code* 1978:sec. 105(a): The court may issue any order, process, or judgement that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, *sua sponte*, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process. *In re Litchfield Co. Ltd. Partnership*, 135 B.R. 797 (W.D.N.C. 1992) held that creditors may be enjoined from proceeding against an individual partner of bankrupt partnership to protect the estate of a debtor.

189 *Laventhol & Horwath v Adkisson* (*In re Laventhol & Horwath)* 1992 WL 88184, the court held that "[t]here is no substantial disagreement within the circuit that a bankruptcy court has the power, in … partnership bankruptcy cases, to grant a preliminary injunction staying litigation against non-debtors when such actions have a significant impact on the debtor or its ability to reorganise and where the non-debtors are not using the bankruptcy in bad faith as a shield against suits".

190 *In re Litchfield Co. Ltd. Partnership*, 135 B.R. 797 (W.D.N.C. 1992).

191 *Chase Manhattan Bank v Third Eighty-Nine Assocs (In re Third Eighty-Nine)* 138 B.R 144 (S.D.N.Y 1992).

192 *In re Third Eight-Nine* 1992:138.

193 *Machlett Laboratories, Inc. v Techny Industries*, 665 F. 2d 795 (7th Cir. 1981). See Yakus v. United States, 321 U.S. 414 (1944); First Citizens Bank & Trust Co. v. Camp, 432 F. 2d 481 (7th Cir. 1970); *In re Spiers Graff Spiers*, 190 B.R. 1001 (Bankr. N.D. Ill. 1996) (injunction jurisdiction discussed). There are essentially four factors that must be established before injunctive relief is granted. See *Commonwealth Life Insurance Co. v. Neal* 669 F. 2d 300 (5th Cir. 1982).

to succeed on the merits of its case; the petitioner must demonstrate irreparable injury if the injunction is not granted; the issue of the injunction must not cause significant harm to other parties involved in the proceedings; and the court should consider any relevant public interest factors.

A reliable factual basis supporting the relief is required to meet the burden of establishing the four factors mentioned above. In *Sampson v Murray,* it was pointed that, at the very least, sworn affidavits or verified pleadings must be presented to the court.[194] In fact, the law is well-established that if parties have been given insufficient time to present their factual evidence, the issuance of a preliminary injunction may be reversed.[195]

The moratorium in Chapter 11 is a good example to follow when promulgating a business rescue procedure for partnerships compared to the Chapter 6 moratorium that was specifically drafted for companies. The main lesson to be drawn here is that a moratorium can protect the partnership business. Where necessary, a partner may apply for a temporal injunction that will prevent the partner's creditors from commencing liquidation proceedings against the partner, which may jeopardise business reorganisation success.

3.3.2.3 Partnership reorganisation plan

The reorganisation plan is important to secure a successful rescue. The following sections explain who is eligible to file a business plan and the different tests used to assess a debtor's intentions and prospects of success. Furthermore, the discourse explains whether a partner reorganisation plan can prescribe a partner's liability for or claim against the partnership. Finally, the section clarifies whether a business reorganisation plan may alter or amend the partnership agreement.

Eligibility to file a plan

A debtor has 120 days to file a reorganisation plan from the day of filing a Chapter 11 petition. [196] This period is called the exclusivity period. Affected persons may not file

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194 *Sampson v Murray*, 415 U.S. 61 (1974); *Dopp v Franklin Nat'l Bank*, 461 F. 2d 873 (2d Cir. 1972).

195 *Northwestern Stevedoring Co. v Marshall*, 41 F. 2d 28 (9th Cir. 1930). *Marshall Durbin Farms, Inc. v National Farmers Org Inc*., 446 F. 2d 353 (5th Cir. 1971); *Consolidation Coal Co. v Disabled Miners of S.W. Va*., 442 F. 2d 1261 (4th Cir.), cert. denied, 404 U.S. 911 (1971).

196 *Bankruptcy Code* 1978:sec. 1121(b).

any reorganisation plan during this period. If the debtor manages to propose the plan within the exclusivity period, it has 180 days to apply for confirmation of the proposed plan.[197] Section 1121(c) provides that if the exclusivity period expires before the debtor files a reorganisation plan, "any party in interests may file a plan."[198]

In re River Bend-Oxford Assocs,[199] the United States Bankruptcy Court, Maryland, was called upon to decide whether a limited partner was eligible to file a reorganisation on behalf of the partnership. A general partner who held 0.5 per cent interest in the partnership objected to the statement in the reorganisation plan filed by two partners (limited and general partners) who held 99.5 per cent interest in the partnership. Derby J held that the general partner in a limited partnership who held 0.5 per cent interest qualified as "partner in interest" is eligible to file and sponsor the reorganisation plan.

Good faith test

The *Bankruptcy Code* 1978 specifies that a reorganisation plan must be proposed in good faith and not prohibited by any law.[200] However, the Code does not define the phrase *good faith*. It is assumed that good faith means that a plan is proposed with the objectives and purposes of the Chapter 11 Code in mind. To determine whether a plan was proposed in good faith, each case must be evaluated within the context of its circumstances. *In re Rosewood at Providence, LLC,*[201] it was held that the focus of a court's inquiry is the plan itself, and courts must look to the totality of the circumstances surrounding the plan. In other words, the determination of good faith is based on the circumstances that led to the creation of the plan. The focus of the inquiry is whether the plan promises to achieve the goals of reorganisation as contemplated

197 *Bankruptcy Code* 1978:sec. 362.

198 *Bankruptcy Code* 1978:sec. 1121(c).

199 *In re River Bend-Oxford Assos* 114 B.R 111 (Bankr. D. Md. 1990).

200 *Bankrupcty Code* 1978:sec. 1129(a)(3). See generally, *In re Coram Healthcare Corp.,* 271 B.R. 228 (Bankr. D. Del. 2001) – conflict of interest of the debtor in possession's CEO, arising from his compensation agreement during the reorganisation period with one of the large creditors, so tainted the reorganisation as to preclude confirmation of a plan under the good faith requirement of section 1129(a)(3), even though conflict was disclosed before the plan's proposal and solicitation, and even though there was no actual showing that harm resulted from the conflict.

201 *In re Rosewood at Providence*, LLC, 470 B.R. 619 (Bankr. M.D. Ga. 2011); Employee Benefits Cas. (BNA) 2819, Bankr. L. Rep. (CCH) P 82897 (M.D. Tenn. 2015), where the debtor proposed a plan for purposes of discharging a pension plan withdrawal liability and engaged in prepetition misconduct, the totality of the circumstances in the case demonstrated bad faith.

in the *Bankruptcy Code*.[202] Thus, a plan that is realistic, protective of the creditors' interest, and capable of creating creditors' return, is proposed in good faith.[203]

Courts have handed down diverging opinions as to whether the conduct of the debtor before filing the reorganisation petition is crucial to the determination of good faith. Certain courts have held that the debtor's conduct before applying for reorganisation is not crucial in determining whether the reorganisation plan is proposed in good faith.[204] For instance, in *In re Cottonwood Corners Phase V, LLC,* [205] it was held that any factual determination by a state court that members of a Chapter 11 debtor acted in bad faith in connection with their pre-petition dealings with a creditor in the past, was not sufficient to serve as a finding that the debtor has not proposed its plan in good faith in violation of section 1129(a)(3). However, other courts contended that the examination of whether a plan has been submitted in good faith should include the debtor's conduct before filing as well as the plan's feasibility.[206] In a similar division of authority, some courts found that previous plans filed in bad faith are not relevant to subsequent filings,[207] while other courts found such conduct as material.[208] I opine that the test for good faith concerning partnerships should consider all the facts of the case. The conduct of the partners before filing for reorganisation and the feasibility of the plan are both crucial in determining whether the proposed plan was created in good

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202 *In re Bashas' Inc.*, 437 B.R. 874 (Bankr. D. Ariz. 2010). The proposed Chapter 11 plan did not violate the Bankruptcy Code's good faith requirements by separately classifying the litigants' claims in order to "gerrymander" the votes; separately classifying a potential class due to its dissimilarity from other unsecured claims was permissible, litigants presented no evidence to prove that their type of unliquidated, disputed claims bore similarities to any other class, and even if litigants were included along with the unsecured class, they would not have controlled or even come close to controlling the class, and so there would have been no manipulation of the class structure to warrant a finding of bad faith.

203 *Garvin v Cook Investments NW, SPNWY, LLC,* 922 F. 3d 1031, 67 Bankr. Ct. Dec. (CRR) 34, Bankr. L. Rep. (CCH) P 83392 (9th Cir. 2019). The court held that a plan satisfied section 1129(a)(3), if the proposal of the plan was in good faith (it provided for the creditors' repayment and the debtors' ongoing operations and therefore was consistent with the objectives and purpose of the *Bankruptcy Code*), notwithstanding the fact that a portion of the Debtor's income may be derived from an illegal activity.

204 *In re MacGibbon*, 2006 WL 6810935 (B.A.P. 9th Cir. 2006). Regarding prepetition conduct issues, such as Deborah's multiple bankruptcy filings, the failure to include creditors in the initial schedules, payments to children and family members, allegedly excessive expenditures and the like, while these topics were fair game in analysing Deborah's good faith in filing for Chapter 11 relief, they did not assist in determining whether her plan was proposed in good faith, the focus of section 1129(a)(3).

205 *In re Cottonwood Corners Phase V, LLC*, 2012 WL 566426 (Bankr. D. N.M. 2012).

206 *In re VDG Chicken, LLC*, 2011 WL 3299089 (B.A.P. 9th Cir. 2011).

207 *In re Wentworth Hills, LLC,* 2011 WL 6301143 (Bankr. D. Mass. 2011). The fact that the initial plan did not provide for an auction of the equity and did provide for the securing of a capital infusion was of no consequence because section 1129(a)(3) asked whether the plan at issue, not earlier iterations, was proposed in good faith.

208 *In re Airadigm Communications, Inc*., 396 B.R. 747 (W.D. Wis. 2007).

faith. The following section explains the best interest requirement, especially if the debtor is a partnership.

Best interest of creditors test

Before a Chapter 11 plan is confirmed, it must satisfy the best interests test as prescribed in section 1129.[209] This test is satisfied if each holder has accepted the plan or that the non-accepting holder will receive more than they would be entitled to under liquidation.[210] The test aims to protect the dissenting members of each class. If the debtor is a partnership, the best interest test must be examined in light of section 723 of the Bankruptcy Code.

In *Bell Road Inc Co v M Long Arabians*,[211] the United States Bankruptcy Appellate Panel of the Ninth Circuit reversed the decision of the Bankruptcy Court to confirm a reorganisation plan without assessing whether the plan complies with section 1129(a)(7) in light of section 723(a). Section 723(a) stipulates the following:

> If there is a deficiency of property of the estate to pay in full all claims which are allowed in a case under this chapter concerning a partnership and with respect to which a general partner of the partnership is personally liable, the trustee shall have a claim against such general partner to the extent that under applicable nonbankruptcy law such general partner is personally liable for such deficiency.[212]

It implies that the partners are required to contribute to the reorganisation plan as far as they are personally liable for the debts and liabilities of the partnership. To satisfy this requirement, partners are required to provide a statement of their assets and liabilities following the Bankruptcy Rule 1007(g). *In re Monetary Group*,[213] the United States Bankruptcy Court M.D. Florida, granted an order instructing the general partners of a partnership under Chapter 11 to file statements of personal assets in

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209 *Bankruptcy Code* 1978:sec. 1129(a)(7). By requiring that a plan must provide that each nonaccepting member of each class receive under the plan at least as much as such member would receive on liquidation, the proponent of a plan is limited in the degree to which value can be taken from senior accepting classes and given to junior classes. See also Coogan 1982:344.

210 In *Southern Pacific Transp. Co. v Voluntary Purchasing Groups, Inc.,* 252 B.R. 373, 391-92 (E.D. Tex. 2000), it was pointed out that before confirming the plan, the Bankruptcy Court should have resolved whether the debtor's proposed discount factor was valid and determined when the plan's effective date would occur, since matters such as asset valuation and estimation of liquidation recoveries may be drastically affected by timing of calculations.

211 *Bell Road Inc Co v M Long Arabians (In re M. Long Arabians)*, 103 B.R 211, 216-217 (Bankr. 9th Circuit 1989).

212 *In re Ridge II* United States Bankruptcy Court, C.D. California. September 17, 1993158 B.R. 1016.

213 *In re Monetary Group*, 55 B.R 297 (Bankr. M.D Fla. 1985).

terms of Rule 107(g).[214] The court reasoned that the solvency of the partners remained an important issue in deciding whether to confirm the reorganisation plan of the partnership. The same position was held in *MBank Corpus Christi v Seikel,*[215] wherein the Court stated that the court must determine the net worth of each partner to determine whether a plan can be confirmed under section 1129(a)(7).[216] *In re Narrows Realty Co*,[217] the partnership reorganisation plan proposed full creditor payment, but the court held that the general partners were required to file a financial balance sheet under Rule 1007(g). The court held that since the plan called for contributions by the general partners, section 1125 required disclosure so that creditors could make informed decisions on the ability of the partners to fund the reorganisation.

The cases discussed above suggest that assessing the partners' assets and liabilities is necessary to determine their ability to fund or supplement the partnership's finances during and after reorganisation. Therefore, although a partnership is recognised as a juristic person for bankruptcy purposes, it remains crucial for the partners to support the partnership during a reorganisation. Without the support of partners, the courts may not confirm the reorganisation plan. It raises the question about the continued liability of partners after confirmation of the plan.

Continued liability of partners

During business reorganisation in Chapter 11, it seems the partners remain liable for the debts and liabilities of the partnership. *In re Union Meeting Partners*,[218] the court ruled that the *best interest of creditors test* was not satisfied by a plan which preserved the creditor's rights against the general partners. The same decision was made *In re Gramercy Twins Assocs*.[219] In this case, the reorganisation plan proposed two options

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214 Under the *Bankruptcy Rule* 1007(g), the court may order any general partner of a partnership to file a statement of personal assets and liabilities within such time as the court may fix.

215 *MBank Corpus Christi v Seikel* (In re I-37 Gulf Ltd Partnership), 48 B.R 647, 650 (Bankr. S.D Tex 1985).

216 *In re I-37 Gulf Ltd Partnership* 1985: 647. In another case, *In re Diversified Investors Fund* XVII 91 B.R 559 (Bankruptcy C.D 1988), the court held that the liquidation analysis in the debtor's limited partnership's disclosure statement must include the net worth of general partners for the court to make the section 1129(a)(7) finding and for the unsecured creditors to have adequate information.

217 *In re Narrows Realty Co.*, 1994 WL 62177 (Bankr. M.D Pa. Jan 6, 1994).

218 *In re Union Meeting Partners*, 165 B.R 553, 575-76 (Bankr. E.D. Pa.)

219 *In re Gramercy Twins Assocs*, 187 B.R 112, 125 (Bankr S.D.N.Y 1995); *Andrew v Coopersmith (In Downtown Inv. Club III),* 89 B.R. 59, 65 (Bankr 9th Cir. 1988), the Ninth Circuit reversed confirmation of the modified plan for a debtor's limited partnership where the bankruptcy judge apparently equated state court rights of partnerships against the general partner to be equivalent to a trustee's rights under Bankruptcy Code section 723(a).

for unsecured creditors: They could accept payment of 99 per cent of their claims and release the general partners; and they could receive two per cent of their claims and retain recourse against general partners.[220] Blackshear J rejected the plan because it failed to meet the best interest tests in section 1129(a)(7). He reasoned that "retention of the secured creditors' rights against the partners does not constitute payment in full pursuant to Chapter 7".[221] In the eyes of the court, the proposed plan failed to create a better return for creditors because it relied on the continued liability of debtors.

The Bankruptcy Court took a different approach in *In re Heron, Burchette, Ruckert & Rothwell*.[222] In that case, the court confirmed a business reorganisation plan that relied on the contribution of former partners. The court held that the Chapter 11 plan does not need to be guaranteed; instead, the plan should be confirmed if it offers reasonable assurances of success.[223] In *In re Duval Manor Associates,*[224] the Bankruptcy Court confirmed a partnership reorganisation plan which separated trade claims from nonrecourse deficiency claims. The court granted the partnership permission to revise its plan without deleting provisions requiring the general partners to pay the remaining balance of trade claims.[225] The decision was later confirmed by the Fifth Circuit Court, which held that, even if the modified plan did not guarantee the payment of trade claims, the District Court did not err in confirming the plan.

It seems that the Bankruptcy Courts are divided as to whether a reorganisation plan of a partnership can rely on the continued liability of partners. Some courts reject the confirmation of plans that depend on the contribution of partners, whereas others view the contribution of partners as not forming part of the reorganisation. I posit that assessing the individual partners' net worth is important to the confirmation of a reorganisation plan because the success or failure of a partnership reorganisation could depend on the partners' contributions.

220 *In re Gramercy Twins Assocs* 1995:113.
221 *In re Gramercy Twins Assocs* 1995:113, 125.
222 *In re Heron, Burchete, Ruckert & Rothwell*, 148 B.R. 660, 666-676 (Bankr. D.D.C 1992).
223 *In re Heron Burchete, Ruckert & Rothwell* 1992:684.
224 *In re Duval Manor Associates* 191 B.R 560, 561 (Bankr. W.D Tex 1989).
225 *In re Duval Manor Associates* 1989:636-637.

Partner's claim against the partnership

A complex issue arising from the reorganisation procedure for partnerships is the classification of a partner's claim against the partnership. *In re Heron, Burchette Ruckert & Rothwell*,[226] the Bankruptcy Court was called upon to decide the ranking of claims of former partners. Teel J held that former partners seeking repayment or indemnification from the partnership might be grouped in the same creditor class. This meant that the partnership reorganisation plan was supposed to include the former partners in the unsecured creditors' category.

In another case, *In re Leck Mahim & Kate*,[227] the United States Bankruptcy Court, N.D. Illinois, confirmed a Chapter 11 plan that classified the *fair recovery contributors'* claims separately from other general unsecured claims. These were claims of partners who paid to settle an action brought by the firm's landlord. A dissenting partner objected to separate classification. The court held that the fair recovery contributors' claims were sufficiently different from other unsecured claims to justify a separate classification. The claim holders were partners and had contributed funds in exchange for a release from personal liability to the landlord. It appears that former partners may be classified as unsecured creditors, while current partners may form a different class of creditors depending on their contribution and its terms. The raises the question: Does a business reorganisation plan modify the relationship of partners? This question will be answered in the following subsection.

Modification of the partnership agreement

When a partnership applies for reorganisation, it has a substantial impact on the relationship between the partners. In *In re Sovereign Group*,[228] the general partner (Pikeview) of a limited partnership debtor filed a motion to stop the confirmation of the Chapter 11 reorganisation plan. Pikeview argued that the plan that called for his replacement violated section 1129(a)(3) of the *Bankruptcy Code*. The crux of his objection was that the reorganisation plan compelled limited partners to associate with the new general partner without their consent, which is contrary to the law of partnerships. According to Pikeview, the restructuring of the partnership created a

226 *In re Heron, Burchette, Ruckert & Rothwell*, 148 B.R. 660, 669-72 (Bankr. D.D.C.).
227 *In re Leck Mahim & Kate*, 1999, WL 1128959 (Bankr. N.D III Dec, 1999).
228 *In re Sovereign Group*, 1984-21 Ltd., 88 B.R. 325, 328-29 (Bankr. D. Colo. 1988).

conflict of interest. The Bankruptcy Court explained that in section 1123, the reorganisation plan could not be confirmed without the affirmative vote of two-thirds of limited partnership interests, which would be impaired under the proposed plan. Hence, the requirement under the limited partnership agreement that a new general partner be admitted as successor only with the consent of a special limited partner and a majority of limited partners complies with section 1123 and does not offend section 1129 of the *Bankruptcy Code*.[229]

I believe that the law of partnerships should not interfere with the reorganisation process, especially the reorganisation plan. The purpose of business reorganisation is to restructure the debtor's business and save it.[230] Therefore, I believe that the reorganisation plan can alter the structure of the partnership or its agreement, if necessary, to save the business and assist the partnership in discharging its debtors.

3.3.2.4 Discharge of the partnership and release of partner

A debtor (partnership) in the Chapter 11 case is discharged when the court confirms the reorganisation plan.[231] However, section 524(e),[232] read with 1141(d)[233] of the *Bankruptcy Code* 1978, provides that the discharge of a partnership does not automatically discharge the partners from liability in respect of the partnership debts and liabilities.[234] However, some courts have issued permanent injunctions in support

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229 See also *In re Block Shim Dev. Co. Irving*, 939 F. 2d 289 (5th Cir. 1991). The reorganisation plan for the debtor's limited partnership provided for a redistribution of partnership interests to reflect the actual capital contributions of the partners during restructuring. The appellate court upheld the Bankruptcy Court's decision over the objection of a general partner whose interest in the partnership would be reduced.

230 *In re Ingleside Assocs*., 136 B.R. 955, 962, 963 (Bankr. E.D. Pa. 1992), the court confirmed a plan under which the partnership agreement was altered to allow for the elimination of the interest of any of the partners if the partner did not contribute to the reorganisation capital. The Bankruptcy Court held that the proposed amendments could have been significant enough to warrant a denial of confirmation under section 1129 (a)(1) or (a), but they were not substantial or unfair.

231 *Bankruptcy Code* 1978:sec. 1141(d). The confirmation of a plan discharges the debtor from any debt that arose before the date of such confirmation.

232 *Bankruptcy Code* 1978:sec. 524(e). Discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.

233 *Bankruptcy Code* 1978:sec. 1141(d)(1). Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan– (A) discharges the debtor from any debt that arose before the date of such confirmation, and any debt of a kind specified in section 502(g), 502(h), or 502(i) of this title, whether or not – (i) a proof of the claim based on such debt is filed or deemed filed under section 501 of this title; (ii) such claim is allowed under section 502 of this title; or (iii) the holder of such claim has accepted the plan; and (B) terminates all rights and interests of equity security holders and general partners provided for by the plan.

234 *Spiers Graff Spiers v Menako (In re Spiers Graff Spiers),* 190 B.R 1001 (Bankr. N.D III 1996). The United States Bankruptcy Court, N.D. Illinois, observed that section 524(e) "at least stands for the proposition that, unless rights of creditors against third parties are expressly addressed in the plan, a plan of reorganisation

of the Chapter 11 reorganisation plans based on the contributions made by partners. The injunctions are meant to protect partners against enforcement actions related to the partnership.

In re Heron, Burchete, Ruckert & Rothwell,[235] is a typical example where the court issued a permanent injunction to protect the partners. In this case, a large law firm was in financial distress and filed a petition for reorganisation in terms of Chapter 11. According to the reorganisation plan, participating partners undertook to contribute ten-year-bearing notes. The amounts of the notes were determined by a two-step process, namely by negotiations with the creditors' committee to determine the necessary aggregate amount, and an allocation committee by the partnership (the debtor) and its partners. One of the terms of the plan was that an accepting vote released the participating partner. A total of 61 of 63 partners voted for the plan, and 84 of 91 creditors voted for the plan. The United States Bankruptcy Court, District of Columbia, issued a permanent injunction protecting participating partners from collection activities by the partnership creditors. The objecting partners contended that the reorganisation plan failed to meet the good faith requirement stipulated in section 1129(a)(3). They argued that the process for determining contributions was unfair. The court confirmed the permanent injunction protecting the participating partners under section 105. The court reasoned that by protecting the assets of participating partners from legal proceedings, the injunction indirectly preserved the partnership's assets during reorganisation. This would increase the likelihood of successful rescue. The court further emphasised that it would not issue a permanent injunction where the debtor sought an injunction to bar suits for fraud. This was not so in this case.

3.3.3 Summary

The United States bankruptcy system provides valuable best practices for inclusion into a business rescue model for UBEs in South Africa. All three chapters in the *Bankruptcy Code* 1978 provide some form of balance between creditors' rights and debtors' desires to reorganise their businesses. The Code is founded on four main

and the resulting discharge of a debtor [partnership] does not affect rights that creditors have against third party non-debtor [partners]

235 *In re Heron, Burchete, Ruckert & Rothwell*, 148 B.R. 660, 666-676 (Bankr. D.D.C 1992).

features, namely the commencement procedure, moratorium against legal proceedings, comprehensive reorganisation plan, and discharge or exit strategy.

The Code provides voluntary commencement procedures for both sole proprietorships and partnerships on the verge of bankruptcy. Compulsory reorganisation procedures by creditors are not allowed for sole proprietorships. Such an application would be regarded as an attempt to subject the sole proprietor under peonage or servitude. It also appears that an individual creditor of a partner may not commence compulsory reorganisation because they do not have direct claims against the partnership. However, partnership creditors, general partners or limited partners who are holders of a separate creditor's claims may apply for compulsory business reorganisation. I am of the view that a partnership may be subject to compulsory reorganisation without committing peonage because partnerships are recognised as legal persons for purposes of bankruptcy.

When a debtor has made an application for reorganisation, a moratorium against enforcement action or legal proceedings becomes effective. The purpose of the moratorium is to restrain creditors from commencing bankruptcy proceedings, while allowing the debtor to prepare a reorganisation plan. If the debtor is a sole proprietorship, the moratorium covers the business and personal debts of the owner. The unique feature of the moratorium in Chapter 13 is that it also protects codebtors. If the debtor is a partnership, the moratorium in Chapter 11 protects the partnership business but does not protect partners. However, partners are permitted to apply for a temporal injunction against legal proceedings initiated by personal or partnership creditors. The applicant (partner) must demonstrate that the legal proceedings could reduce the prospects of successfully reorganising the partnership if creditors are not restrained. It allows the partners to concentrate their resources on the reorganisation of the partnership rather than paying creditors.

On the one hand, to protect creditors from *mala fide* applications, Congress has included stringent requirements to confirm a reorganisation plan. First, the debtor must satisfy the good-faith test. This test aims at separating honest and fraudulent debtors. The second test is the *best interest of creditor's test*. If the debtor is a sole proprietorship, the debtor must also meet the *means test*. The main purpose of these

two tests is to establish if business reorganisation is feasible. In other words, the test is a litmus paper on the debtor's prospects of being reorganised.

On the other hand, uncooperative creditors may be cramdown, especially where secured creditors have consented to the reorganisation plan. Cram-down means that creditors are bound to comply with the reorganisation plan even though they did not approve or vote for it. This approach ensures that creditors do not dismiss reorganisation plans merely because certain creditors are not comfortable with rearranging their debts.

In Chapter 11, partnerships are discharged when the court approves the reorganisation plan. The effect thereof is that partnership creditors cannot commence bankruptcy proceedings unless they can show that reorganisation has failed. Chapter 13 provides a different approach. A sole proprietorship is discharged upon completion of payment or when the debtor can no longer make payments because of an unforeseen circumstance or event. Discharge after complete payment of debts is preferable for the creditors. However, debtors sometimes fail to pay not by choice but because of factors beyond their control, for instance, if the debtor's business is washed away by a hail storm or consumed by fire.

For this reason, the Code authorises a discharge of certain debts to rehabilitate the debtor. The main lesson here is that UBEs may be discharged when they have substantially paid their operational and administrative expenses. Furthermore, in cases of natural disasters, sicknesses and unexpected events, the hardship discharge may assist debtors who are already attempting to rescue the business and satisfy their debts. Such ideas may be incorporated into the rescue process for UBEs. The next section examines the different approaches to rescuing UBEs in financial distress used in the UK.

3.4 UNITED KINGDOM

A sole proprietorship or partnership in financial distress has a variety of options in terms of IA 1986.[236] These options include DROs, IVAs, partnership administration

[236] Statistics show that most individual debtors involved in economic activities chose individual voluntary arrangements and partnerships favour administration orders. Milman 2017:630 observed that there is a growing trend among individuals involved in economic activities to resort to debt management plans, rather than the formal insolvency procedures. See also Ramsay 2012:240. This does not necessarily mean that

orders, and partnership voluntary arrangements. The first two options apply to sole proprietorships, whereas partnerships may utilise the other two procedures. These rescue processes are also known as the alternatives to bankruptcy. The following parts examine each of the four procedures and draw lessons for South Africa. The discussion begins with DROs.

3.4.1 Debt relief orders

In brief, a DRO creates a 12-month moratorium during which creditors identified in the order may not commence any remedies against the debtor. At the end of the moratorium, the debtor is discharged from all his debts listed in the order. During the 12-month period, the debtor may repay its creditors from its income or revenue. The sections that follow examine the steps that debtors should follow until discharged.

3.4.1.1 Applications for a debt relief order

A debtor in financial difficulties may apply to the official receiver's office for a DRO.[237] The debtor applies on an online portal, which can only be accessed through an approved intermediary.[238] The intermediary assists the debtor by identifying the required information and documentation.[239] Ramsay stated that the term *debt relief order* was used to protect debtors from the stigma of bankruptcy.[240] Furthermore, the simplified online portal is meant to promote the financial inclusion of poor debtors.[241] Generally, academics[242] and judges[243] have welcomed the debt relief process as a low-cost and time-efficient process. In *R (on the application of Amanda Howard) v The*

individuals no longer use formal business rescue procedures. The first quarter of 2019 recorded 16 714 individual voluntary arrangements and 6 875 debt relief orders.

237 Crossley 2008:12-13; Gallagher 2009:34-46; Newbury 2013:5-6; O'Sullivan 2009:10-12; Van Rooyen 2008: 128:55-57; Wright 2014/15:14-15.

238 *Insolvency Act* 1986:sec. 251U(1)-(2). An intermediary is a list available on the Insolvency Service website of "competent authorities" that can refer a debtor to an approved intermediary which include the Citizens Advice Bureau, Step Change Debt Charity. See also Insolvency Intelligence 2015:46.

239 *Insolvency Act* 1986:sec. 251B(4)(b). *Insolvency Proceedings (Fees) Order* 2016/692 Sch.1. For the full service, the debtor pays only £90 (approximately R1 850).

240 Ramsay 2018:614.

241 Hansard 2006:766. When introducing the DRO, the government stated that "it deals with those who cannot pay their debts and are unable to access current procedures of debt relief … [it seeks] to promote financial inclusion".

242 Wright 2014:14. Fletcher 2009:386 argued that the primary aim of this approach is to reduce the cost involved in bringing about an orderly resolution of the debt relief order.

243 *Secretary of State v Payne* [2011] UKSC 60: 63. In this case, the Court held that it has described the procedure as "a new and simplified way of wiping the slate clean for debtors who are too poor to go bankrupt".

OR,[244] Stadlen J commented that the debt relief process is meant to accommodate individual debts with relatively low levels of debt and limited income to clear their debts.[245] From the onset, the DRO procedure is designed to operate without the court's involvement unless an affected party invokes its intervention on one of the grounds provided in section 251 of IA 1986.[246] Thus, the reduced formality may also prove to be convenient for self-employed debtors.

When the official receiver receives an application for debt relief from a sole proprietorship, the following factors should be considered: First, the official receiver should determine which debts qualify for a DRO, including tax payable.[247] Qualifying debts are those that are due immediately or within a certain time in the near future.[248] Excluded debts include fines, maintenance, students loans, [249] any debts arising from contravening the *Proceeds of Crime Act*,[250] contractual obligations under the *Consumer Protection Act*[251] and financial responsibilities arising from the *Social Security Contributions and Benefits Act.*[252] It appears that excluded debts are those debts that have nothing to do with conducting business, while the DROs are concerned with debts arising from conducting business. The second factor requires the official receiver to assess the debtor's income.[253] In terms of the Insolvency Rule 9.7, income includes any payment in respect of the carrying on of a business or in respect of an office.[254] Third, the official receiver should determine which business assets can be

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244 *R (on the application of Amanda Howard) v The Official Receiver* [2013] EWHC 1839 (Admin), 2013 WL 3197240.

245 *R (on the application of Amanda Howard) v Official Receiver* [2013]: par. 60. "The debt relief order … is a simplified bankruptcy regime to meet a need for a low-cost personal insolvency procedure designed to enable debtors with relatively low levels of debt and limited surplus income to clear their debts.

246 These grounds are discussed in Chapter 3.

247 *Insolvency Act* 1986:sec. 251A(1)-(3).

248 *Insolvency Act* 1986:sec. 251.

249 *Insolvency Rules* 2016/1024: Rule 9.2 *excluded debts* include any fine imposed for an offence; any obligation (including an obligation to pay a lump sum or to pay costs) arising under an order made in family proceedings or any obligation arising under a maintenance assessment or maintenance calculation made under the *Child Support Act* 1991, for student loan debts.

250 *Proceeds of Crime Act* 2002: Parts 2, 3 or 4.

251 *Consumer Protection Act* 1987, Part 1: Any debt which consists of a liability to pay damages for negligence, nuisance or breach of a statutory, contractual or other duty, or to pay damages, being in either case damages in respect of the death of or personal injury (including any disease or other impairment of physical or mental condition) to any person.

252 *Social Security Contributions and Benefits Act* 1992:sec. 138(1)(b). Any obligation arising from a payment out of the social fund by way of crisis loan or budgeting loan.

253 *Insolvency Rule* 2016: rule 9.7(1) and (2).

254 *Insolvency Rule* 2016: rule 9.7(1). For the purpose of this part, the income of a debtor comprises every payment in the nature of income which is from time to time made to the debtor or to which the debtor from

disregarded in assessing how much property the person owns.[255] It should be noted that the distinction between included debts and excluded debts suggests that it is possible to separate personal debts from business debts when dealing with an individual who is operating a business as a sole proprietorship. Furthermore, an individual involved in commercial activities is capable of paying off creditors from the revenue generated by the business. The court can also take the initiative on hearing a debtor's bankruptcy petition by diverting the debtor into the DRO process.[256]

3.4.1.2 Debt relief moratorium

Once the application is submitted, the DRO may be approved or refused.[257] If the application is approved, the DRO should complete the prescribed form and include a list of the qualifying debts.[258] The DRO creates an immediate moratorium during which creditors listed in the DRO will have no remedy against the debtor regarding the debts listed.[259] Furthermore, the creditor may not commence any legal proceedings against the debtor unless the court grants leave to initiate such a proceeding.[260]

The purpose of the moratorium is to give the debtor time to pay its debts without any interruption from legal proceedings.[261] The moratorium does not eliminate the debt. Instead, it only suspends the rights of creditors to demand payment.[262] In *R. (on the application of Payne) v Secretary of State for Work and Pensions,*[263] the Court of Appeal had to decide the meaning of "remedy in respect of the debt". In its full context,

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time to time becomes entitled, including any payment in respect of the carrying on of a business or in respect of an office or employment and any payment under a pension scheme.

255 *Insolvency Rule* 2016: rule 9.8; Charlton 2013:46-50.

256 *Insolvency Act* 1986:sec. 274A.

257 *Insolvency Act* 1986:sec. 251C. Sec. 251C(2) states that the official receiver can raise queries with the debtor before making his final determination.

258 *Insolvency Act* 1986:sec. 251E(2) and (3). The list has to include details of each creditor and the amount owed to them.

259 *Insolvency Act* 1986:sec. 251G(1)-(2). A moratorium commences on the effective date for a debt relief order in relation to each qualifying debt specified in the order ("a specified qualifying debt"). (2) During the moratorium, the creditor to whom a specified qualifying debt is owed– (a) has no remedy in respect of the debt, and (b) may not– (i) commence a creditor's petition in respect of the debt, or (ii) otherwise commence any action or other legal proceedings against the debtor for the debt, except with the permission of the court and on such terms as the court may impose.

260 *Insolvency Act* 1986:sec. 251G(1)-(2).

261 Fletcher 2009:387; Madge 2014:56-60; Newbury 2013:5-6.

262 *Irwell Valley Housing Association Ltd v Docherty* [2012] EWCA Civ 704 par. 14. It is clear that the debt relief referred to in the statute itself is a suspension of the debt rather than its elimination because the discharge only takes place at the end of the moratorium period.

263 *R. (on the application of Payne) v Secretary of State for Work and Pensions* [2011] UKSC 60; [2012] 2 A.C. 1.

the phrase reads as follows: “During the moratorium, the creditor to whom a specified qualifying debt is owed has no *remedy in respect of the debt*.”[264]

In this case, the respondents applied for a DRO in which they listed the Secretary of State for Works and Pension (hereafter Secretary) as a creditor. The DRO was granted. The respondents owed the Secretary social grants that were overpaid to them. Although the DRO was granted, the Secretary continued to deduct money from their benefits. The respondents challenged the right to keep on deducting payments from a debtor who has applied for a DRO. The legal question was whether deductions to recover overpaid benefits was a “remedy in respect of the debt” within the meaning of section 251G(2) of IA 1986. The Secretary argued that section 251G(2)(a) should be read with section 285(3), which provides that the secretary of state has a “remedy against the property or person of the bankrupt”. Such an interpretation permits the Secretary to make deductions during the bankruptcy of the recipient. He further argued that there are no policies to the effect that the Parliament intended to treat a debtor under DRO differently from a bankrupt. Besides, a beneficiary of the grant was only entitled to the net amount after any lawful deductions (the net entitlement principle).[265] The court held that a literal reading of section 251G(2(a) ascribes an ordinary meaning to the words “remedy in respect of the debt”, concluding that the Secretary’s deductions were made in the exercise of a “remedy” as envisioned by the legislature. Thus, the deductions were prohibited by the moratorium.

The same court took a different approach in *Places for People Homes Ltd v Sharples.*[266] The creditor applied for repossession of its property. The Court of Appeals held that an order for repossession of the property was sought not to settle the rent debt but to restore the landlord’s full proprietary rights. Thus, the proceedings were not barred by the moratorium. It seems that the term *remedy in respect of the debt* does not include any other remedy against the debtor.

The moratorium continues for 12 months unless terminated early or extended by the court.[267] When the moratorium expires, the debtor is released from the debts stated in

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264 *Insolvency Act* 1986:sec. 251G(2).

265 *R. (on the application of Payne) v Secretary of State for Work and Pensions* [2011]: par. 12.

266 *Places for People Homes Ltd v Sharples* [2011] EWCA Civ 813; [2012] Ch. 382.

267 *Insolvency Act* 1986:sec. 251H.

the order and any additional sums that may have become payable. [268] A DRO will be recorded in the Individual Insolvency Register maintained by the Insolvency Service. The Individual Insolvency Register contains details of DROs that are current or have ended in the last three months.[269] After three months, the debtor's file is deleted from the records.

3.4.1.3 Objections, investigations, and revocations

The DRO process attempts to balance the interest of creditors and that of the debtor by allowing listed creditors to present their objections against granting the order. Creditors may object to the inclusion of the debt as a qualifying debt or the details of the debtor.[270] Any objection has to be raised within 28 days from being notified of the DRO.[271] These objections must be considered by the official receiver, who has the power to revoke or amend the DRO, if appropriate.[272] Creditors, as the primary beneficiaries of the debtor's estate, and other interested parties should be able to assess both the administration of the estate and the conduct of the insolvency representative in carrying out its duties.[273] This implies that if the creditors or the debtor are not satisfied with the decision of the official receiver, they may appeal to a court of law. Although the official receiver's office deals with applications for debt review orders, it is argued that the court of law should make any reviews of the conduct of the official receiver.

A DRO cannot be amended to include a debt that was not previously listed.[274] The official receiver may investigate any matters that appear relevant to the decision whether to revoke or amend the DRO.[275] In this regard, the official receiver may revoke a DRO if the debtor provided incorrect or misleading information or failed to comply with the requirements stipulated in the order.[276] The official receiver may also revoke

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268 *Insolvency Act* 1986:sec. 251I(1).

269 *Insolvency Act* 1986:sec. 251W.

270 *Insolvency Act* 1986:sec. 251K(1). See also Milman 2009:153 There is an important quality control mechanism in sec. 251K in that it allows creditors with qualifying debts to object, whereupon the official receiver must investigate.

271 *Insolvency Act* 1986:sec. 251K(2).

272 *Insolvency Act* 1986:sec. 251K (3); sec. 251L(1).

273 UNCITRAL 2005: 205 par. 116.

274 *Insolvency Act* 1986:sec. 251L(9).

275 *Insolvency Act* 1986:sec. 251K (4).

276 *Insolvency Act* 1986:sec. 251L(2)(a); sec. 251L(2)(b); Möser 2013:79.

a DRO if the debtor erred in the assessment of the application, for instance, by wrongly classifying debt as a qualifying debt.[277] The official receiver can also revoke a DRO if the debtor's surplus income or revenue have changed.[278] The power to revoke a DRO must be exercised during the term of the moratorium. In considering when the revocation should take effect, the official receiver must consider (in the light of the grounds on which the decision to revoke was made and all the other circumstances of the case), whether the debtor ought to be given the opportunity to make arrangements for making payments towards his debts.[279]

A DRO made by the official receiver can run its course without the court's involvement. However, the court may hear applications challenging the official receiver's conduct or the official receiver may also approach the court for extensions of the moratorium period.[280] The Court has the authority to revoke a DRO even after the moratorium has expired.[281] This would make void the discharge of the qualifying debts that have not been fully paid.

3.4.1.4 Debt relief restrictions orders

In cases of dishonest or otherwise blameworthy behaviour on the part of a debtor subject to a DRO, the court has the power to make a debt relief restrictions order.[282] The order prohibits the debtor from applying for DROs for a period of two to fifteen years. [283] The effect of a debt relief restriction order is not specifically set out in one section of the Act. However, references to the consequences of an individual being subject to a debt relief restriction order can be found in various parts of legislation.

I opine that DROs are mainly based on the honesty of the debtor. Therefore, they are subject to abuse. Creditors' involvement in the process is limited. Thus, the procedure is only ideal for debtors with a few creditors. Furthermore, DROs are restricted to

277 *Insolvency Act* 1986:sec. 251L(2)(b); sec. 251L(3).
278 *Insolvency Act* 1986:sec. 251L(4).
279 *Insolvency Act* 1986:sec. 251L(6).
280 *Insolvency Act* 1986:sec. 251.
281 *Insolvency Act* 1986:sec. 251M(7).
282 *Insolvency Act* 1986: Sch.4ZB par. 1(1).
283 *Insolvency Act* 1986: Sch.4ZB par. 4(2).

qualifying debts. It suggests that the other creditors may commence bankruptcy proceedings against the debtor.[284] A more radical but effective procedure is the IVA.

3.4.2 Individual voluntary arrangements

In short, an IVA is a statutory process under Part 8 of IA 1986, whereby the debtor agrees with its creditors to pay all or part of the debtor's debts.[285] The procedure is overseen by an insolvency practitioner who collects and distributes regular payments by the debtor.[286] The essence of the process is that the debtor makes proposals for payments towards discharging the debts. The creditors consider these proposals and decide whether to accept them. The following is an analysis of some of the features of IVA that may be beneficial to UBEs.

3.4.2.1 Interim order

A business debtor (sole trader or partner in a partnership) who intends to propose a debt rearrangement plan to creditors[287] may apply to the high court[288] for an interim order.[289] The interim order prevents creditors from commencing bankruptcy proceedings against the debtor.[290] Affected parties will also be prohibited from commencing other proceedings such as an enforcement action or execution proceedings without the leave of the court.[291] However, the official receiver is not prohibited from securing any assets belonging to the debtor unless the court orders that bankruptcy proceedings stay.[292] It is important to note that an interim order does

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284 More detail on the debt restrictions order, is provided by Butler 2012:54-56.

285 Fletcher 2009:51; Frieze 2001:49; Mayner, 1990:34; Tolmie 2003:86. IVA numbers and the IVA share of the individual insolvency "market" rose significantly until 1990 when almost 14% of formal insolvencies were dealt with in this way. In 1991, the share dropped to 11.71 per cent, perhaps as the initial "novelty" wore off, or the sudden halt in house price appreciation made many IVA proposals more marginal. However, it appears that after 32 years, IVAs remain the most used debt relief procedure in England and Wales. Thorp 2019:135-136; 2017:3738 argued that formal bankruptcy has a more negative impact on social capital through stigma effects than the alternative of individual voluntary arrangements.

286 *Insolvency Act* 1986:sec.388(2)(c).

287 On the status of a creditor, see also *Booth v Mond* [2010] B.P.I.R. 1111; *CMEC V Beesely* [2010] EWCA CiV 1344.

288 The grounds on which the court's jurisdiction is to be exercised are designed to prevent the debtor from misusing the procedure.

289 *Insolvency Act* 1986:sec. 252. The Standard Conditions for Individual Voluntary Arrangements 2004:4(1) provides that the arrangement is a proposal for a scheme of arrangements of the debtor's affairs or a composition in full and final satisfaction of the debtor's debts.

290 *Insolvency Act* 1986:sec. 254 as amended by the *Insolvency Act* 2000: sch. 3 par. 2.

291 *Insolvency Act* 1986:sec. 254; Beale 2018:20-50; Tolmie 2003:86.

292 *Insolvency Act* 1986:sec. 254; Frieze 2001:50-51.

not relax any restrictions imposed on a debtor who has been declared bankrupt.[293] This means that a debtor who has been prohibited from trading cannot continue operating its business. The general intention of the legislative provisions is to provide a short period during which the debtor's affairs can be looked into by an independent insolvency practitioner while allowing the creditors to consider the debtor's proposal to rearrange its debts.[294]

Before the court makes an interim order, it must be satisfied that the debtor intends to make a proposal; the debtor is an undischarged bankrupt; the debtor has not made an interim application in the last 12 months, and the debtor's nominee is willing to assess the debtor's financial situation.[295] The court may issue an order if it believes it is necessary to facilitate the consideration and implementation of the debtor's proposal.[296]

In evaluating the debtor's application, the court must be satisfied that the debtor's proposal is genuine and viable. This requirement was discussed in *Singh v Singh*.[297] In this case, the court *a quo* dismissed an application for an interim order because there were no prospects that the creditors would vote for the IVA. The Appeal Court held that the creditors should vote for the IVA at the creditors' meeting.[298] Thus, the decision to dismiss an application for an interim order would prejudice the majority of creditors who have not had the opportunity to vote for or against the applicant's IVA.

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293 *Insolvency Act* 1986:sec. 255.

294 *Cove (A Debtor), Re* [1990] 1 W.L.R. 708 Ch; Debtor (No.13A-IO-1995), Re [1995] 1 W.L.R: 1127: "It is clear that both section 252(2) and section 11(3) are intended by the legislature to provide a breathing space to enable a rational scheme for the realisation of assets for the benefit of creditors to be considered and formulated. However, the provisions of section 11(3) and section 252(2) are significantly different in that, for example, the former prohibits without the leave of the court the levying of distress for rent as well as 'proceedings' and 'legal process' whereas section 252(2) does not."

295 *Insolvency Act* 1986:secs. 251, 252 *Jones (A debtor)* (VA 289 OF 1994) Re (Unreport, 1995) (QBD). A detailed discussion on the discretion of the court is provided by Thomas 1996:19-20; see also general comments by Greenberg 2020:2 and Pond 1995:118-130.

296 *Insolvency Act* 1986:sec. 252.

297 *Singh v Singh* [2013] EWHC 4783 (Ch)*; Davidson v Stanley* [2004] 10 WLUK 841.

298 *Singh v Singh* 2013: par. 21.

An interim order is effective for 14 days, but in practice, it lasts until the day the creditors decide to conduct a creditors' meeting.[299] The order gives a debtor a temporary breathing space to prepare a viable IVA proposal.[300]

The next step after the order, is to prepare an IVA proposal and meet with creditors. At the creditors' meetings, all stakeholders have the opportunity to vote for or against the proposal. Considering that the debtor is not yet subject to bankruptcy proceedings at this stage, creditors have the opportunity to discuss the procedure that can best serve their interests.[301] This approach attempts to balance the interests of both the creditors and the debtor. On the one hand, the debtor may begin the procedure by enjoining the creditors from exercising their rights while preparing an IVA proposal. On the other hand, creditors have the power to accept or reject the debtor's proposal. Both parties to the IVA have a chance to protect and promote their interest.

3.4.2.2 Debtor's individual voluntary arrangement proposal

The debtor must prepare a proposal in the form of a composition or scheme of arrangement while the interim order is in effect.[302] Section 253 states that the proposal should identify a nominee to act as an overseer or supervisor of the arrangement.[303] A nominee may be a qualified insolvency practitioner or any other authorised person who is willing to oversee the execution of the IVA.[304] Furthermore, the proposal should explain why the debtor believes a voluntary arrangement is desirable and why creditors will likely agree. It also has to provide details on the debtor's assets and liabilities.[305] The Insolvency Rules require that the proposal includes details on the

299 *Insolvency Act* 1986:sec. 255(6); Greenberg 2020:1-7; Pond 1995:121.

300 *Debtor (No.13A-IO-1995), Re* [1995] 1 W.L.R. 1127 Ch.). The Standard Conditions for Voluntary Agreement version 4, 2018: The interim order gives the debtor room to negotiate an IVA. An approved IVA will invariably provide for a stay on individual collection efforts and freeze interests in outstanding debts.

301 *Hook v Jewson Limited* [1997] 1 BCLC 664. The courts now consider the nominee's report and the debtor's IVA at the same time as the application for an interim order. This approach reduces the cost of proceedings and also serves time.

302 *Insolvency Act* 1986:sec. 256A. Whether or not an interim order has been made, the process of obtaining an IVA essentially begins with a proposal by the debtor submitted to a nominee, for purposes of the nominee to prepare a report which can be considered by creditors.

303 *Insolvency Act* sec. 253; *Insolvency Rules* 1024/2016:8.3. The essence of the requirement is for the debtor to submit to the nominee a document (proposal) setting out the terms of the IVA, which the debtor is proposing to the creditors. The proposal is accompanied by a statement of affairs, including details of the creditors, debts and other liabilities and assets.

304 *Insolvency Act* 1986:sec. 253.

305 *Insolvency Act* 1986:sec. 256A.

treatment of secured and unsecured creditors.[306] If a debtor is involved in a trade or profession, details can be provided on the conduct of the business during the implementation of the IVA, the manner of handling any funds arising during this time, any further proposed credit facilities.[307] Generally, the debtor's proposal must provide a comprehensive set of objectives and a clear time frame for achieving these goals.[308] The information provided by the debtor intends to assist the creditors in making an informed decision.

It seems that IVAs are better equipped to facilitate a quick recovery for debtors involved in economic activities than for consumers' debtors. If the debtor is a trader or professional, the IVA allows the debtor to continue operating its business. In addition, such a debtor may secure post-commencement finances using their business assets. These are the essentials for the survival of the business during restructuring or rescue.

If the debtor is an undischarged bankrupt, the debtor must nominate a trustee.[309] Does this mean that an IVA creates a trust in favour of creditors? *In re McKeen*[310], Morritt J held that the effect of the IVAs that the assets comprised in the voluntary arrangement vest in the debtor's trustee in bankruptcy, and this does not make a voluntary arrangement a trust. However, the nominee takes the debtor's assets to implement the voluntary arrangement for the benefit of the creditors. Harman J *In re Leisure Study Group Limited*[311] and Rimer J *In re Bradley Hole*[312] held that the company's voluntary arrangements and IVAs involve trusts, with the supervisor being the trustee. Hence, the view that an IVA amounts to a trust is consistent with the requirement that a nominee can be a trustee. It is important to state that whether the debtor nominates

306 *Insolvency Rule* 2016: rule 8.5 gives detail about the statement of affairs which the debtor is required to submit to the nominee under ss.256 or 256A. It must contain, in particular, a list of assets, particulars of the claim and security, details of preferential creditors and unsecured creditors, debts owed to associates, and debts owed to the debtor by associates.

307 *Insolvency Rule* 2016: rule 8.3 sets out details of the content to be included in a proposal, including considerable detail about information to be given in respect of assets, liabilities, nominee's fees and expenses, the identification of the proposed supervisor, any guarantees and proposed guarantees in respect of the debtor's debts, proposed timing (including duration) of the IVA, classification of proceedings, proposals for the conduct of business during the IVA details of any further proposed credit facilities, the manner of handling of any funds arising, details of any other proposal in the previous 24 months, and "any other matters which the debtor considers appropriate to enable creditors to reach an informed decision on the proposal".

308 Standard Conditions for Individual Voluntary Arrangements 2004:3-11.

309 *Insolvency Act* 1986:sec. 253(2).

310 *In re McKeen* (a debtor) [1995] B.C.C. 412.

311 *In re Leisure Study Group Limited* [1994] 2 B.C.L.C. 65.

312 *In re Bradley Hole* [1995] 1 W.L.R. 1097.

an insolvency practitioner or a trustee, the nominee must remain independent and act in the best interests of all stakeholders.

3.4.2.3 Nominee's report

The debtor must prepare and submit the proposal to the nominee. The nominee is required to provide a report two days before the interim order is discharged.[313] The report should state whether a meeting of the creditors should be summoned to deliberate on the debtor's proposal.[314] It is not meant to approve the proposal but to explain whether the debtor's proposal warrants a meeting of the creditors.

If the debtor is an undischarged bankruptcy, the debtor should submit a copy of the nominee's report, the IVA and a financial statement to the official receiver.[315] If the nominee recommends that there is no need for the creditors to meet, reasons must be provided why the debtor can perform its obligations, whether the agreement is feasible and if there is an acceptable alternative to bankruptcy.[316]

I believe that the opinion of the nominee is essential to save the court's time and the debtor's finances. The nominee evaluates the viability of the IVA on behalf of the creditors, debtor and any affected person; therefore, the nominee's opinion must remain independent and objective. The nominee should liaise with the debtor's creditors to ascertain whether they agree with the proposed voluntary arrangement.[317] Acceptance of the debtor's proposal by the creditor at this stage may persuade the court to approve the IVA.

3.4.2.4 Creditor's evaluation of the debtor's proposal

One of the innovative features of IVAs provided by IA 1986 is the involvement of creditors. In terms of section 157, the nominee must seek approval of the debtor's

313 *Insolvency Act* 1986:sec. 256, where an interim order has been made on an application under section 253, the nominee shall, before the order ceases to have effect, submit a report to the court stating (a) whether, in his opinion, the voluntary arrangement which the debtor is proposing has a reasonable prospect of being approved and implemented, and (aa) whether, in his opinion, the debtor's creditors should consider the debtor's proposal.

314 *Insolvency Act* 1986:sec. 256A (3).

315 *Insolvency Act* 1986:sec. 256A (3).

316 *Insolvency Act* 1986:sec. 256A (3)(a).

317 *Insolvency Act* 1986:sec. 257(2).

proposal. IA 1986 suggests that the decision to approve or reject the debtor's proposal is to be made by a creditor's decision procedure.[318]

The notice of the creditor's decision procedure must be communicated to all creditors on the nominee's list provided by the debtor.[319] Creditors may approve the debtor's proposal with or without modification.[320] If the proposal is modified, the creditors still need to require the consent of the debtor.[321] More importantly, the creditor cannot approve a proposal prohibiting secured creditors from enforcing their security unless they agree.[322] In *Whitehead v Household Corp*, the court held that a mortgagee may agree to modify their right to the property, but this does not mean the entire debt will be treated as unsecured.[323]

If the creditors at the creditors' meeting approve the debtor's proposal, it becomes binding on every creditor or person.[324] The proposal is binding on everyone regardless of whether the affected person consented or objected to its approval.[325] In *Johnson v Davies*[326] the Court of Appeal had the opportunity to explain the implications of section 260(2). It was held that section 260(2) is not intended to impose the arrangement directly on dissenting creditors. Instead, the dissenting creditor is bound by the IVA as a result of the operation of law, not that the creditor is presumed to be present and consenting to it. The conclusion is based on the statutory hypothesis that creditors must be treated as if they were present at the meeting and consented.[327]

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318 *Insolvency Act* 1986:sec. 257(2A). Doyle 1996:13-15. The current procedure is contained in the Standard Conditions for Individual Voluntary Arrangements 2018.

319 *Insolvency Act* 1986:sec. 257(2B).

320 *Insolvency Act* 1986:sec. 258.

321 *Insolvency Act* 1986:sec. 258(2).

322 *Insolvency Act* 1986:sec. 258(4); *Insolvency Rules* 1986: rule 5.23(3).

323 *Whitehead v Household Mortgage Corp plc* [2003] 1 All ER 319.

324 *Insolvency Act* 1986:sec. 257.

325 *Insolvency Act* 1986:sec 257 read with sec 260(2).

326 *Johnson v Davies* [1999] Ch. 117 CA.

327 *Johnson v Davies* 1999: par. 127. The statutory hypothesis is that the person who has notice of and was entitled to vote at the meeting is party to an arrangement to which he has given his consent. It is important to keep in mind that, where B and C are codebtors of A, the reason why C is released as a result of an arrangement or bargain between A and B is that the effect of that bargain is to extinguish the debt; alternatively, that the effect of that bargain is that A has agreed with B that A will not sue C on a debt which, if paid by C, will give C rights of contribution against B and so negate the release from any further liability in respect of that debt which is the basis of B's arrangement with A. C is not released by reason of any arrangement or bargain between A and C *inter se*; and it is no answer to point out, as is the case, that there is nothing in sec. 260(2) of the Act which purports to affect the rights of A and C *inter se*. This finding was also followed in *Inland Revenue Commissioners v Adam and Partners Ltd [2000] B.C.C. 513 Ch*. *Smith-Evans v Smailes* [2013] 7 WLUK 915.

3.4.2.5 Objections against the creditors' decision

The outcome of the creditors' meeting is communicated to all creditors by the nominee.[328] A creditor may challenge the creditors' decision if he or she believes that the IVA is not in the best interest of all creditors or if there are irregularities in reaching the decision to approve the IVA.[329] Such an application must be made 28 days after the creditors' meeting or the day the IVA is registered at the IVR.[330]

In *Tager v Westpac Banking Corporation*[331] the court held that sections 262 and 263 are designed to ensure that all challenges to an IVA's legality, based on claims of irregularities at the creditors' meeting, are handled within a reasonable time. These two sections are discretionary so that the court may remedy a minor irregularity that may, at common law, invalidate the process.[332] This is one of the advantages of the IVAs provided by IA 1986. At common law, if one creditor merely votes against the arrangement, it falls away.[333] In other words, it invalidates the proposed individual arrangement.

3.4.2.6 Implementation of voluntary arrangement

If there are no objections,[334] the next step would be implementation. The implementation of a voluntary arrangement is regulated in terms of section 263 of IA 1986. The nominee is regarded as the supervisor of the IVA.[335] If the debtor or any of the creditors are not satisfied with the decisions made by the supervisor, they may approach the court.[336] The court may revoke, confirm or modify the decision of the

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328 *Insolvency Act* 1986:sec. 259(1)(a).

329 *Insolvency Act* 1986:sec. 262(1) and (2).

330 *Insolvency Act* 1986:sec. 262.

331 *Tager v Westpac Banking Corporation* [1998] BCC 73.

332 *Tager v Westpac Banking Corporation* [1998]: 38. The obvious purpose of these two subsections, read together, is to ensure that all challenges to the validity of an IVA based upon an alleged irregularity at or in relation to a creditors' meeting are resolved within a very tight time limit (subject to the court's power to extend) and dealt with by more flexible court powers than the blunt weapon of a declaration of invalidity. It both prevents such challenges being made long after the event, and avoids what would otherwise be the automatic consequence of invalidity, namely the debtor and the creditors always having to re-start the IVA process again, from scratch. In particular, the court's powers under sec. 262 are discretionary, so that a minor irregularity which might at common law invalidate the process, could nonetheless leave the statutory outcome intact, where, for example, the irregularity caused no sensible prejudice to a complainant creditor (or debtor) wishing to wreck the IVA for wholly collateral reasons.

333 *Prinsloo v Van Zyl* 1967 (1) 581 (T): 583. This is one of the reasons why the South African common law compositions fail to rescue sole proprietorships in financial distress.

334 Hardwicke 2018:186-187.

335 *Insolvency Act* 1986:sec. 263(2).

336 *Insolvency Act* 1986:sec. 263(1).

supervisor. It means that the IVA is overseen by the supervisor, the debtor and creditors. The court is available where there are disputes.[337] The debtor is released after the full implementation of the plan and the supervisor issues a certificate of completion.[338]

The sections above only explore the formal procedures applicable to sole proprietorships. The following sections explain alternatives to bankruptcy that apply to partnerships.

3.4.3 Partnership administration orders

The administration order in Schedule B1 of IA 1986 was meant for companies and was fundamentally unsuited for partnerships.[339] Then IPO 1994 was promulgated to modify the procedure to suit the needs of insolvent partnerships.[340] This section explores the administration procedure for partnerships. The analysis focuses on five main themes: the commencement procedure, application of moratorium, development of a reorganisation plan, implementation of the plan, and the discharge of the partnership from the procedure.

3.4.3.1 Commencement proceedings

The partners of an insolvent partnership may file a petition for an administration order.[341] The only other persons who may make such an application are one or more

337 *Bridgend Goldsmiths Ltd*, Re [1995] B.C.C. 226 Ch.

338 In *Green v Wright* [2017] EWCA Civ 111, the Court of Appeals held that the terms of the IVA included the clause "upon the issue by the supervisor of a Completion Certificate, the debtor shall be released from all debts which are subject to the Arrangement". See also Marland 2017:16.

339 Berry 2018: 88-91; see also *Official Receiver v Hollens* [2007] EWHC 754 (Ch); [2007] Bus. L.R. 1402: para [29]; Banks 2017: para.27-01; Sealy & Milman 2011: 738; Blackett-Ord & Haren 2015: para.22.2; Milman 2005: 11; Morse 2015: para.8.02; Company Law Newsletter 2003: 1-2 "The new system would not apply automatically to insolvent partnerships and the Insolvent Partnerships Order would have to be amended as necessary (under the power under s.420 of the Insolvency Act 1986 under which the 1994 Order was made in the first place). Essentially the same streamlined process is intended to apply to insolvent partnerships subject to changes mainly due to the fact that partnerships cannot create floating charges except agricultural floating charges. The nature and purpose of administration would remain the same for partnerships as for companies, with the primary objective being the rescue of the partnership and as much of the business as possible. See also Frieze 1995:33-35.

340 Totty *et al*. 2021: Chapter 11. The *Insolvency Act* 1986 ushered in an statutory instrument in the form of IPO enacted pursuant to section 420 of the Insolvency Act 1986 which enabled the Lord Chancellor to provide that such provisions of the Insolvency Act might be specified in the IPO, should be applied in relation to insolvent partnership with such modification as might be specified.

341 *Insolvency Act* 1986:sec. 9(1) and as modified in Schedule 2 of the IPO 1994.

of the partnership's creditors or a combination of a member of the partnership and creditor(s).

In *Patley Wood Farm LLP v Brake,*[342] the High Court held that a member[343] with minority shares in a partnership could not unilaterally apply for an administration order on behalf of the partnership, especially where the partnership agreement provided otherwise.[344] However, the court reasoned that if the partnership is insolvent and administration proceedings were viable, the applicant could add a creditor as a party to the application.[345]

It appears that one partner may apply for an administration order alone if the partnership agreement specifically requires unanimity for an administration order. In terms of section 24(8) of PA 1980, a majority vote is required for ordinary matters.[346] Nevertheless, when it comes to issues related to change in the nature of the partnership business, partners must make a unanimous decision. This means that in cases where partners could not reach a unanimous decision to file a petition for administration, a single partner can do so with the assistance of a creditor. Upon receiving an application for an administration order, article 5 of the IPO provides that the court may make an order in relation to a partnership only if it is satisfied that the partnership is unable to pay its debts and that the administration order is reasonably likely to achieve the purpose of administration.

3.4.3.2 Moratorium in administration

If the court grants an order for administration, a moratorium automatically takes effect. The moratorium enjoins creditors from enforcing their rights or debts against the partnership without the administrator's consent or the court's leave.[347] The moratorium in administration intends to provide the administrator with time to formulate proposals and implement any proposal approved by the creditors. The process may result in the reorganisation of the partnership or the winding up of the whole business. However,

342 *Patley Wood Farm LLP v Brake and others (trading as Stay in Style)* 2016 WL 07840657.

343 Since insolvency partnerships are regarded as unregistered companies, partners are recognised as members of the unregistered company, i.e partnership.

344 *Patley Wood Farm LLP v Brake and others (trading as Stay in Style)* 2016.

345 *Patley Wood Farm LLP v Brake and others (trading as Stay in Style) 2*016.

346 *Partnership Act* 1890:sec. 24.

347 *Partnership Insolvency Order* 1994:art. 6, par. 4; see also O'Dea 2009:583.

article 6, par. 42 of the IPO 1994 does not allow courts to order winding up proceedings while the insolvent partnership is in administration.

The following subsections provide an analysis of article 6, par. 43 of IPO 1994, which provides the modified moratorium applicable to insolvent partnerships. The subsections examine the scope and extent of the moratorium in partnership administration. The primary question relates to the extent to which the moratorium in administration protects the interest of creditors while providing a scapegoat for the insolvent partnership. The discourse also determines whether partners are protected as contributors to the partnership or exposed to bankruptcy proceedings.

Moratorium against partnership property

Article 6, par. 43(2) of IPO 1994 stipulates that "no step may be taken to enforce security over the partnership property".[348] It seems logical and prudent to protect the partnership's property since it forms the foundation of the business's survival as a going concern. The partnership property is essentially the property of the business, and administration proceedings are meant to maximise the property's value. This poses the question of what constitutes the property of the partnership for the purpose of partnership administration.

Soon after the promulgation of the IPO, scholars such as Kavanagh and Marks attempted to answer this question but did not provide an answer and left it to the courts.[349] IPO 1994 states that "partnership property" has the same meaning as in PA 1890. In PA 1890, partnership property means property acquired or brought into the partnership estate during the subsistence of the partnership business.[350]The property must be held and used exclusively for the benefit of the partnership.

In *Barton v Morris*,[351] Nicholls J held that the crucial question related to the intention of the partners was when they bought the property. In this case, the court emphasised that the property held by two persons as joint tenants does not automatically become

348 *Partnership Insolvency Order* 1994:art. 6, par. 43(2).

349 Kavanagh 1995: 92-93; Marks 1996:73-75.

350 *Partnership Act* 1890:sec. 20(1). All property and rights and interests in property originally brought into the partnership stock or acquired, whether by purchase or otherwise, on account of the firm, or for the purposes and in the course of the partnership business, are called in this Act *partnership property*, and must be held and applied by the partners exclusively for the purpose of the partnership and in accordance with the partnership agreement

351 *Barton v Morris* [1985] 2 All ER 1032, [1985] 1 WLR 1257.

the assets of a partnership unless evidence shows that they intended to include the property as an asset of the partnership.

Section 20(1) of PA 1890 provides three separate tests that can be used to determine whether the property falls within the partnership's estate. First, was the property originally bought into the partnership stock? Second, was it acquired by purchase or otherwise on account of the firm? Third, was it acquired for the purposes and in the course of the partnership business?[352] From these statutory tests, it seems that the property surrendered by the partners as a contribution at the commencement of a partnership, forms part of the partnership property. It also includes any property that was bought by the partnership during the subsistence of the partnership.[353] I opine that the partnership property protected by the moratorium in partnership administration includes the contributions by the partners and any other property acquired by or for the partnership.

Moratorium against repossession of goods

According to article 6, par. 43(3), "no step may be taken to repossess goods in the partnership's possession under the hirepurchase agreement".[354] The term *hire purchase agreement* is defined in IA 1986 as including conditional sale agreements, chattel leasing agreements and retention of title agreements.[355] The moratorium against repossession of property aims to guarantee equal treatment of all classes of creditors, especially unsecured creditors. It makes sense that during administration, creditors should not be allowed to repossess their goods lest they spark panic among other creditors who may want to enforce their rights against the partnership.

IA 1986 or IPO 1994 does specify whether "possession" should be lawful or unlawful. It appears that if the hirepurchase agreement is not valid or if the debtor partner breaches one of the terms of the hirepurchase agreement, the creditor may not commence proceedings without the consent of the administrator or leave of the court. I am of the view that the legality of a moratorium in paragraph 43(3) rests upon the validity of the hirepurchase agreement. The moratorium only prohibits the creditors

352 *Jack v Jack* [2016] CSIH 75; 2016 Fam. L.R. 177 (IH (Ex Div)); *Bourne v Davis (t/a Brandon Davis Publishing)* [2006] EWHC 1567 (Ch); [2006] 6 WLUK 341 (Ch D).

353 Banks 2017:18-06; see also Baden-Powell 2007:36-38; Thomson 2017:7-8.

354 *Insolvent Partnership Order* 1994: art. 6, par. 43(3).

355 *Insolvency Act* 1986:sec. 10(4).

from commencing repossession proceedings, which does not include proceedings aimed at ascertaining the validity of the agreement. This argument is based on the assumption that the moratorium intends to protect lawful possession. If possession is unlawful, then administration proceedings should not be used to protect the debtor partnership. The law protects only law-abiding debtors. If the creditor believes that possession is not lawful, then acquiring the administrator's consent or the leave of the court should only be a matter of formality.

Moratorium against the right of forfeiture

A landlord is enjoined from enforcing its right of forfeiture by peaceable re-entry in relation to premises forming part of the partnership property.[356] Paragraph 43(4) seems to temper the landlord's right to property. It provokes the question: Does article 6, par. 43(4) of the IPO provide sufficient protection for the creditors, namely the landlord? The general rule is that a creditor may not commence any proceedings against the debtor. However, the exception to the rule is that a creditor may commence legal proceedings against the insolvent partnership only with the consent of the administrator or the leave of the court.

In *IB Capital Markets Plc & Anor v Atlantic Computer Systems Plc,*[357] the Court of Appeal held that Parliament must have intended that when the administrator or the court exercise discretion, they should consider the property rights of the parties concerned. This process entails a balancing of the rights of the creditor and the insolvent partnership. The court further held that the parliament intended the courts to consider several factors affecting the creditors and the debtor. These factors include the impact of granting or refusing on the debtor's financial position, the period the administration order is expected to remain in force, the main objective of the administration, and the prospects of achieving that objective.[358]

Protection of partners during the administration

The partnership administration order only protects the partnership, while partners remain exposed to bankruptcy proceedings.[359] In other words, the moratorium in

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356 *Insolvent Partnership Order* 1994: art. 6, par. 43(4).

357 *AIB Capital Markets Plc & Anor v Atlantic Computer Systems Plc & Ors* [1990] EWCA Civ 20 (25 July 1990): par. 30.

358 *AIB Capital Markets Plc & Anor v Atlantic Computer Systems Plc & Ors* [1990]: par. 30.

359 Frieze 1995:33.

administration prohibits partnership creditors from commencing legal proceedings against the partnership estate. However, the personal creditors of partners can still enforce their rights or commence legal proceedings against the partners. This is the main weakness of the administration procedure. When the personal creditors of partners commence bankruptcy proceedings, it encourages the partnership creditors to sue partners for partnership debts. In essence, the attention moves from the partnership to the partners.

The problem is rooted in section 9 of PA 1890 which provides that partners are jointly liable for all the debts and liabilities of the partnership.[360] Partnership creditors cannot wait for administration proceedings, while personal creditors are already depleting the resources of the main contributors of the partnership. Furthermore, when partners are under sequestration, some professions or trades such as accounting and bankers are no longer allowed to hold any office. This, in turn, affects the administration proceedings because partners will not be available to continue operating the business. Proceedings against partners frustrate administration proceedings and reduce the prospects of success of the whole procedure. To solve this problem, partners apply for an IVA simultaneously with the application for an administration order. This procedure allows the partner to apply for an interim order that prohibits personal and partnership creditors from enforcing their rights or commencing legal proceedings.

This approach is not effective for two reasons. First, applications for an administration order and interim order are costly; thus, the rescue procedure becomes cost ineffective. Second, if one of the partner's applications for an interim order is rejected, their estate becomes vulnerable to bankruptcy proceedings. For this reason, I recommend that parliament should consider the US Bankruptcy Code 1978, section 105, which allows partners to apply for temporal protection against personal and partnership creditors.[361] The advantage of a temporal injunction is that solvent partners do not need to apply for IVAs. It is important to note that partners are the main contributors to the administration procedure. If their finances and assets are directed to personal creditors, the prospects of rescuing the partnership decreases.

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360 *Partnership Act* 1890:sec. 9. Every partner in a firm is liable jointly with the other partners for all the debts and obligations of the partnership incurred while he is a partner and after his death, his estate is also severally liable in due course of administration for such debts and obligations so far as they remain unsatisfied but subject to the prior payment of his separate debt.

361 *Bankruptcy Code* 1978:sec. 105.

Hence, the administration procedure should be amended to include a temporal injunction that enjoins personal or partnership creditors from commencing legal proceedings. As a safeguard of the creditor's interests, the partners must demonstrate on a balance of probabilities that if creditors are allowed to commence legal proceedings, this will frustrate or lower the chances of rescuing the partnership business.

3.4.3.3 Partnership statement of proposals

The partnership administrator is required to prepare a statement of proposals and make recommendations to the creditors within eight weeks of being appointed.[362] The administrator may require any relevant person to provide them with the partnership statement of affairs.[363] The statement of affairs must include the partnership property, debts and liabilities; and the names and addresses of the partnership creditors.[364] Moreover, it must specify the security held by each creditor and provide the date on which each security was granted.[365] This information is crucial in preparing a statement of proposal; hence, the statement must be verified by a statement of truth signed by the deponent.[366]

The statement of proposals may include suggestions for disposing of the partnership's asset(s), voluntary partnership arrangement or any measure that may maximise the value of the partnership's assets for the benefit of the creditors.[367] At this stage, I only focus on the sale of the partnership's property and then with the partnership's voluntary arrangements.

After evaluating the partnership's financial situation, the administrator may propose the disposal of one of the partnership's assets. It appears that the administrator may not dispose of the partnership's property before the creditors' meeting. In recent years, a practice has developed whereby, in urgent cases, administrators have entered into a conditional contract for the sale of the company's business or assets before the

362 *Insolvent Partnership Order* 1994: par. 49(5); *Insolvency Act* 1986:sec. 23.
363 *Insolvent Partnership Order* 1994: art. 6 par. 47(1).
364 *Insolvent Partnership Order* 1994: art 6 par. 47 (2)
365 *Insolvent Partnership Order* 1994: art. 6 par. 47(2)(e).
366 *Insolvent Partnership Order* 1994: art. 6 par. 47(a).
367 *Insolvent Partnership Order* 1994: art. 6 par. 49(3).

creditors' meeting.[368] However, such a transaction requires the leave of the court. Section 14(3) enables the administrator to apply to the court for directions in relation to any matter arising in connection with the administration.[369] Administrators have found it difficult to obtain such leave of the court. In *Re Consumer & Industrial Press Ltd (No. 2)*,[370] the administrators applied for an order to allow charged assets to be sold as though they were unencumbered before the creditors' meeting. They argued that unsecured creditors were not expecting to receive any dividend from the debtor company; hence, their views were irrelevant. Gibson J held that the underlying philosophy behind requiring the creditors to meet is that any major decision regarding the fact of the insolvent debtor must remain in their hands.[371] Thus, disposal of the company's assets should only be allowed in extremely urgent circumstances.

In another case, *Re NS Distribution Ltd*,[372] the court was called upon to exercise its discretion in terms of section 14(3) to permit an administrator to dispose of the company's leasehold before the creditors' meeting. Harman J dismissed the application, holding that the leasehold property in question was one of several remaining assets of the company and its disposal was not the sole remaining matter left to be determined by the creditors.[373]

The two cases point out two important considerations before the administrator decides to sell the partnership property prior to the creditors' meeting. First, the administrator may only dispose of the partnership property where it is shown that it is urgent to do so. Second, the asset must be the only asset remaining the property of the partnership. I believe that the legislature should provide guidelines to administrators when dealing with partnerships with single assets. If the administrator finds a buyer willing to pay a

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368 *Consumer & Industrial Press Ltd (No. 2), Re* (1988) 4 B.C.C. 72; [1987] 12 WLUK 88 (Ch D (Companies Ct)); NS Distribution, Re [1990] B.C.L.C. 169 [1990] 1 WLUK 451; *PD Fuels Ltd, Re* [1999] B.C.C. 450 [1998] 6 WLUK 57 (Ch D (Companies Ct)).

369 *Insolvency Act* 1986:sec. 14(3).

370 *Consumer & Industrial Press Ltd (No.2), Re* (1988) 4 B.C.C. 72; [1987] 12 WLUK 88 (Ch D (Companies Ct)) (1988) 4 B.C.C. 72; Bacon 1998:73-75.

371 *Re Consumer & Industrial Press Ltd* 1988:78.

372 *Re NS Distribution Ltd* [1990] B.C.L.C. 169. On page 73 the court held that: "I am very unhappy indeed at the suggestion that the court should make an order such as will mean that there can be no useful meeting of creditors. It seems to me that the power that the court undoubtedly has under s. 15 should only be exercised in circumstances in which it can readily be seen that the disposals are the only sensible course to be adopted and when the unsecured creditors have had a chance to say what they think about the proposals in the administration. It seems to me that quite exceptional circumstances would be needed for the court to frustrate that part of the Act which requires a meeting of the creditors to consider proposals by the administrators."

373 *Re NS Distribution Ltd* [1990]: 169.

considerable price, the administrator should not wait for three months to elapse to obtain the creditors' consent.

3.4.3.4 Discharge of partnership from the administration process

When the administrator has completed the statement of proposals, it must be served on all partners, creditors and submitted to the court.[374] A creditors' meeting must be held to consider the proposed plans.[375] At the meeting, the creditors may reject or accept the administrator's proposal with modification.[376] If the creditors approve the plan, the administrator oversees its implementation. It should be noted that an administration process is not an end in itself. It does not come to an end. Instead, it is a route to protect the business and trade while another outcome is being considered. Such an outcome may be saving the partnership as a going concern, commencing a partnership voluntary arrangement, or achieving a better value for the assets and business than in bankruptcy or winding up. However, after evaluating the partnership's financial situation, the administrator may file a notice of insufficient property to the court.[377] The notice implies that the partnership estate cannot pay all creditors. Upon filing such a notice, the appointment of the administrator ceases to have an effect.[378] At the end of the three months from the date of filing the notice of insufficient funds, the partnership is deemed dissolved.[379]

Another possible outcome is that the administrator may negotiate with creditors for a PVA. On that note, the following section explains the PVA process.

3.4.4 Partnership voluntary arrangement

A partnership in financial distress may apply for a PVA.[380] This section explains the PVA process and concentrates on the following features: the debtor's eligibility to file for PVA, the nominee's report, the creditors' meeting and implementation, approval of the PVA and implementation of the PVA and discharge of the partnership.

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374 *Insolvent Partnership Order* 1994: art. 6, par. 49(4). Make sure whether insolvency or insolvent
375 *Insolvency Act* 1986:sec. 23.
376 *Insolvency Act* 1986:sec. 24.
377 *Insolvent Partnership Order* 1994: art. 6, par. 84.
378 *Insolvent Partnership Order* 1994: art. 6, par. 84(3)
379 *Insolvent Partnership Order* 1994: art. 6, par. 84(5).
380 *Insolvent Partnership Order* 1994: art. 6, par. 1.

3.4.4.1 Eligibility to make an arrangement

It appears that four persons may apply for a PVA on behalf of an insolvent partnership, namely one of the members of the partnership, an administrator, a liquidator or trustee. A partner may commence the PVA by proposing to other partners and the partnership creditors an arrangement in satisfaction of the debts and liabilities of the partnership.[381] The administrator may also propose a PVA where the partnership is in administration.[382] Furthermore, the liquidator of an insolvent partnership is required to consider a PVA before winding up the partnership,[383] and a trustee may also propose a voluntary arrangement if the court issues an order in terms of article 11 of IPO 1994.[384]

3.4.4.2 Nominee's report to the court

In terms of Article 6, par. 1(2), the proposal must provide a nominee who will act as the supervisor of the PVA. The nominee must be a qualified insolvency practitioner.[385] If the partners do not intend to apply for a moratorium, the nominee should submit a report to the court within 28 days after serving notice of the proposal for a voluntary arrangement.[386] The nominee should explain if the proposed voluntary arrangement has a reasonable chance of approval and implementation in the report. Furthermore, the nominee should determine whether the proposed arrangement should be considered by a meeting of the members and creditors of the partnership.[387]

It is argued that the legislature's intention in requiring the nominee to provide a report to the court is to provide a proper evaluation of the partnership's state of affairs to the court, members of the partnership, the creditors and all affected persons. The opinion of the nominee must therefore be independent and honest. Although a member of the partnership may have appointed the nominee, their opinion must not be biased

381 *Insolvent Partnership Order* 1994: art. 4, par. 1.

382 *Insolvent Partnership Order* 1994: art. 4, par. 1.

383 *Insolvent Partnership Order* 1994: art. 4, par. 1(3).

384 *Insolvent Partnership Order* 1994: art. 4, par. 1(3), read with article 11.

385 *Insolvent Partnership Order* 1994: art. 4, par. 1(2).

386 *Insolvent Partnership Order* 1994: art. 4, par. 2(2).

387 *Insolvent Partnership Order* 1994: art. 4 par. 2(2)(a)-(b). "The nominee should state whether, in his opinion, the proposed voluntary arrangement has a reasonable prospect of being approved and implemented. (b) whether, in his opinion, the proposal should be considered by a meeting of the members of the partnership and by the partnership's creditors, and (c) if in his opinion it should, the date on which, and time and place at which, he proposes a meeting should be held."

towards any group of affected persons. After considering the nominee's report, the court may order that the members of the partnership and its creditors meet to consider a PVA.

3.4.4.3 Meeting of the partnership creditors and the members of the partnership

The nominee's report must specify the date, time and place where the members of the partnership and the creditors are to meet to consider the PVA.[388] The decision of the partnership creditors must be determined through an elaborate procedure that allows every creditor to participate.[389] In terms of article 4, par. 4 of IPO 1994, the members of a partnership and its creditors may decide to approve the PVA with or without modifications.[390] The modifications may include appointing a qualified insolvency practitioner as the supervisor of the implementation of the PVA. It is important to state that IPO 1994 prohibits any modifications that may affect the right(s) of creditors of the partnership to enforce security unless they consent to such modifications.[391] However, modifications may be made with the approval and consent of the relevant creditor. After the meeting, the chairperson of the meeting will present a report to the court.[392]

3.4.4.4 Approval of the partnership voluntary arrangement

The decision of the partnership creditors or the members of the partnership is only effective if the procedure of the meeting has been complied with.[393] In cases where the decision taken by the partnership creditors differs from the decision taken by the members of the partnership, any member of the partnership may approach the

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388 *Insolvent Partnership Order* 1994: art. 4, par. 3.

389 *Insolvent Partnership Order* 1994: art. 4, par. 3(1)(4). A notice of the qualifying decision procedure must be given to every creditor of the partnership of whose claim and address the person summoning the meeting is aware.

390 *Insolvent Partnership Order* 1994: art. 4, par. 4. This section applies where, under section 3, a meeting of the members of the partnership is summoned to consider the proposed voluntary arrangement, and the partnership creditors are asked to decide whether to approve the proposed voluntary arrangement.

391 *Insolvent Partnership Order* 1994: art 4. Sec. 4(4) "(a) any preferential debt of the partnership is to be paid otherwise than in priority to such of its debts as are not preferential debts, … (b) A preferential creditor of the partnership is to be paid an amount in respect of an ordinary preferential debt that bears to that debt a smaller proportion than is borne to another ordinary preferential debt by the amount that is to be paid in respect of that other debt. A preferential creditor of the partnership is to be paid an amount in respect of a secondary preferential debt that bears to that debt a smaller portion than is borne to another secondary preferential debt by the amount that is to be paid in respect of that other debt." *Insolvent Partnership Order* 1994: art. 4, sec. 4. Reference in this section to preferential debts whether ordinary, or secondary preferential debts and preferential creditors are to be read with sect 386 in Part XII of the Insolvency Act of 1986.

392 *Insolvent Partnership Order* 1994: art. 4, par. 4(6).

393 *Insolvent Partnership Order* 1994: art. 4, par. 4(A). It is important to stress that the decision must have complied with procedures created in contemplation of sec. 3.

court.[394] Such an application may be made after 28 days, beginning from the day on which the creditors made the decision.[395] Article 4, section 4A, empowers the court to set aside the decision of the partnership creditors and uphold the decision of the members of the partnership.[396]

If the PVA has been approved by both the partnership creditors and the members of a partnership, it becomes binding on every person who was entitled to vote or who would have been entitled to vote if they had received the notice of the meeting.[397] Since the PVA binds partnership creditors, the question arises whether this prevents the partnership creditor from commencing legal proceedings against the partnership members in their personal capacities.

There is a division of opinion among scholars and practitioners. Some argue that assuming that the creditors of a partnership have accepted payment of a certain percentage in full or by instalment, they cannot pursue the individual members.[398] This approach is only acceptable if the partnership does not default in payment. Others contended that the PVA only binds partnership creditors from enforcing their rights against the partnership, but they are not prohibited from suing individual members of the partnership.[399] It seems that if partners are not protected by the moratorium, personal and partnership creditors can still commence enforcement proceedings against their estate. This argument is based on the notion that partners are personally liable for the debts and liabilities of the partnership. To remedy this gap, it is recommended that if a partnership applies for a PVA, partners should also apply for the IVA. Under the IVA, they can also apply for an interim order prohibiting both personal and partnership creditors from commencing legal proceedings against the partner.

394 *Insolvent Partnership Order* 1994: art. 4 par. 4(A)(2). Where the partnership is a Prudential Regulation Authority regulated partnership, the regulator is entitled to be heard on the application.

395 *Insolvent Partnership Order* 1994: art. 4, par. 4(A)(3) and (4).

396 *Insolvent Partnership Order* 1994: art. 4, par. 4A(6).

397 *Insolvent Partnership Order* 1994: art. 4, par. 5.

398 Frieze 1995; Marks 1996:73-75; Otter 1995:2-4; Smith 1999:56-59.

399 Frieze 1995; Marks 1996:73-75; Otter 1995:2-4; Smith 1999:56-59.

3.4.4.5 Implementation of the partnership voluntary arrangement and discharge of the partnership

The implementation of a PVA is regulated in terms of article 4, section 7 of IPO 1994. According to this provision, the person who was appointed as nominee becomes the supervisor of the PVA.[400] The supervisor may apply to the court for any directions on matters arising from the implementation of the PVA. It also includes making an application for an administration order on behalf of the partnership.[401] A PVA comes to an end when it is fully implemented or when the court issues an administration or winding-up order.[402]

3.4.5 Summary

The debt relief and business rescue schemes available in the UK are collectively known as alternatives to bankruptcy. They provide relief or rescue solutions for a debtor on the brink of bankruptcy. Debt relief orders and IVAs apply to sole proprietorships and partners in a partnership, whereas partnership administration orders and PVAs apply to ordinary partners, limited partnerships and LLPs. The central theme in the UK rescue scheme for sole proprietors and partnerships is voluntariness. It appears that all debtors, regardless of their form, commence business rescue voluntarily. There are no provisions for creditors to initiate a compulsory business rescue.

Debt relief schemes for sole proprietorships appear to be easy, affordable and time effective. Debt relief orders can be applied online with the assistance of an intermediary. Before the debtor applies for a DRO, the intermediary reviews the application and advises the debtor if it qualifies for a DRO. The whole process is facilitated by official receiver, who is authorised to reject or accept applications for DROs. Thus, the process can be completed without the involvement of the courts. If the debtor's application is successful, a moratorium comes into effect. The moratorium under the DRO is effective for 12 months. After this period, the debtor is discharged from all qualifying debts. However, there are certain obligations that the debtor may still be required to meet, which include rentals. During the moratorium, creditors are

400 *Insolvent Partnership Order* 1994: art. 4, par. 7(2)(a) and (b).
401 *Insolvent Partnership Order* 1994: art. 4, par. 7(4).
402 *Insolvent Partnership Order* 1994: art. 4, par. 7(4).

prohibited from commencing any legal proceedings against the debtor. Nevertheless, creditors have a 28 day period to lodge their objections against the issuance of a DRO. If they fail to meet this timeline, the courts may not hear their matters. Equally important, if it is established that the debtor provided false information or evidence on its application, the court may issue a debt relief restriction order which prohibits the guilty debtor from applying for any DRO. South Africa can consider the DRO as an example of a debt relief that may assist sole proprietorships with only a few creditors. The online platform may prove to be cheap and easily accessible. The moratorium may enjoin both personal and business creditors from commencing any proceedings against the debtor.

A sole proprietorship may also apply for an IVA. It seems that the debtor commences the process by applying for an interim order which is effective for 14 days. This order is meant to enjoin all creditors from initiating legal proceedings, while the debtor prepares a proposal for a scheme of arrangement. After the 14-day moratorium, the nominee is required to prepare and present a report on the debtor's proposal to the court. At the court, the nominee is mandated to advise the court if it is necessary to summon the meeting of creditors to consider the debtor's proposal. When evaluating the debtor's proposal, the nominee must pay attention to the treatment of unsecured and secured creditors. Furthermore, whether the business will be capable of meeting its obligations. If the court summons the meeting of the creditors, the creditors must decide on the procedure to be followed in approving or rejecting the debtor's proposal. They may approve the debtor's proposal with or without modifications. Where the debtor's proposal is approved, the nominee becomes the supervisor of the IVA and oversees the implementation of the IVA. The same path is taken by a partnership that must apply for a PVA. The main difference between an IVA and PVA is that the moratorium only protects the partnership property. It is recommended that partners should simultaneously apply for an IVA when they decide to commence PVA proceedings. The main lesson for South Africa is that sole proprietorships and partnerships may be allowed to propose voluntary arrangements. This type of business rescue allows the debtor to continue its business and also outsource further finances. In addition, when creditors do not agree, the aggrieved party may approach the court instead of nullifying the arrangement. The moratorium is central to the

success of the procedure in that it is capable of enjoining personal and business creditors from suing the debtor (sole proprietorships or partnerships)

Another valuable lesson for South Africa is taken from the administration procedure. A partnership in financial distress may also make use of a partnership administration order. Administration orders closely resemble business rescue in Chapter 6 of CA 2008 in that the main purpose of the procedure is to save a viable partnership in financial distress. The difference between the two is that while Chapter 6 business rescue accepts a better return for creditors if the survival of the debtor cannot be secured, administration orders is not an end in itself, but a means to the recovery of the business. Thus, instead of providing two remedies, the partnership administration procedure is designed to either rehabilitate the insolvent partners or commence a PVA. If these two outcomes cannot be achieved, then the object of administration becomes achieving a better value of the assets of the partnership. The main target of the procedure is to avoid bankruptcy proceedings and to ensure that the insolvent partnership has all the opportunities to rehabilitate its business. Basically, if South Africa considers Chapter 6 to include partnerships, the partnership administration order is a good example to follow. Kenya also provides a variety of options for sole proprietorships and partnerships.

3.5 KENYA

The insolvency law in Kenya demonstrates the struggles and successes experienced by developing countries in attempting to promulgate a business rescue regime that attracts foreign investors[403] and promotes local entrepreneurs.[404]

In Kenya, the new IA 2015 provides alternatives to bankruptcy, a set of business rescue processes aimed at avoiding liquidation or sequestration.[405] This section

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403 During the parliamentary debates on the Insolvency Bill, former President Mwai Kibaki noted that there was a critical need to review and reform the insolvency law, to enhance Kenya's competitiveness for business and investment." Parliament Speech 2012 cited by Too 2016:1-3; see also Kamau 2010:1.

404 *Kenya Vision 2030*: vii. The aim of the *Kenya Vision 2030* is to become a "globally competitive and prosperous country with a high quality of life by 2030". It aims at transforming Kenya into "a newly industrialising, middle-income country providing a high quality of life to all its citizens in a clean and secure environment". This vision seems to coincide with South Africa's National Development Plan (NDP) 2030 that aims at eliminating poverty and reduce inequality by 2030. According to the NDP, South Africa can realise these goals by drawing on the energies of its people, growing an inclusive economy, building capabilities, enhancing the capacity of the state, and promoting leadership and partnership development throughout society.

405 A recent study conducted by the Flagship Report of the World Bank Group on the effectiveness of the current insolvency laws (liquidation and business reorganisation procedures) in Kenya indicates that the debt

examines the alternatives to bankruptcy that apply to sole proprietorships and ordinary partnerships: voluntary arrangements, expedited voluntary arrangement, summary instalment orders, and no-asset procedures. This part excludes the voluntary arrangement procedure because the procedure is almost identical to the IVAs of the UK IA 1986. The discussion, therefore, begins with the expedited voluntary arrangement.

3.5.1 Expedited voluntary arrangement procedure

Under the expedited voluntary arrangement scheme, the debtor proposes a rearrangement of its debts and nominates the official receiver to act as the supervisor of the implementation process.[406] The official receiver takes charge of the whole process and begins by filing the debtor's proposal with the court. The next step would be presenting the plan to the creditors on a "take it or leave it" basis, and the creditors either approve or reject the proposal.[407] After receiving communication from the creditors, the official receiver informs the court if the IVA is accepted or rejected.[408] In turn, if the proposed arrangement is accepted, the court sets aside any bankruptcy orders against the debtor.[409] The proposed voluntary arrangement becomes an order of court and binds all creditors.

3.5.1.1 Commencement procedure

A debtor may apply for an expedited voluntary arrangement to avoid bankruptcy proceedings. The debtor must meet four requirements: The debtor must first intend to make a proposal to creditors and second, the debtor must have nominated the official receiver as the supervisor of the voluntary arrangement.[410] Third, the debtor should be an undischarged bankrupt, and, fourth, the debtor should not have applied for an

recovery rate has improved. It is reported that the time required to recover debt ranges from one to four years, while the cost of recovering a debt is approximately 22 per cent of the debtor's estate and the strength of the whole insolvency framework is rated 13.0 out of 16. World Bank Group Flagship Report (Doing Business) 2019: 53-54.

406 *Insolvency Act* 2015: subdivision 2, secs. 316-320.

407 *Insolvency Act* 2015:sec. 316(3).

408 *Insolvency Act* 2015:sec. 317. As soon as reasonably practicable, the arrangements under sec. 316 have been implemented, the official receiver shall report to the court whether the proposed voluntary arrangement has been approved or rejected.

409 *Insolvency Act* 2015:sec. 318(4).

410 *Insolvency Act* 2015:sec. 316(1). "This section applies if a debtor intends to make a proposal to the debtor's creditors for a voluntary arrangement and– (a) the debtor is an undischarged bankrupt; (b) the official receiver is specified in the proposal as the provisional supervisor in relation to the proposal; and (c) no application for an interim order has been made under sec. 304.

interim order.[411] IA 2015 defines *bankrupt* as a debtor who has been declared bankrupt and has not been discharged from bankruptcy.[412]

It appears that a debtor who is already subject to bankruptcy proceedings may apply for an expedited voluntary agreement. In other words, IA 2015 allows a debtor to convert bankruptcy proceedings to an expedited voluntary arrangement. This approach is in line with the Legislative Guidelines, which state that it is desirable for a commencement procedure to be transparent, easy to access and facilitate the conversion of proceedings.[413] However, an expedited voluntary arrangement can only suspend bankruptcy proceedings if the creditors approve and the court nullifies the bankruptcy order.[414]

The advantage of having allowing debtors to convert a bankruptcy case to a rescue or debt relief case, is captured in *Richter v Absa Bank Limited.*[415] In this case, the court held that if it appears during liquidation that business rescue proceedings will result in a higher return for shareholders and creditors and that employment would be preserved, there is no reason to reject an application for business rescue just because a company is in final liquidation.[416] Accordingly, it is argued that if a sole proprietorship is in liquidation and the debtor shows that an expedited voluntary arrangement will yield a better return, IA 2015 allows the debtor to convert the liquidation case to that of a voluntary arrangement case.

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411 *Insolvency Act* 2015:sec. 316(1)(a) and (c).

412 *Insolvency Act* 2015:sec. 2.

413 UNCITRAL 2005:45, par. 21. As a general principle it is desirable that the commencement standard be transparent and certain, facilitating access to insolvency proceedings conveniently, cost-effectively and quickly to encourage financially distressed or insolvent businesses to voluntarily commence proceedings. It is also desirable that access be flexible in terms of the types of insolvency proceedings available (reorganisation and liquidation), and the ease with which the proceedings most relevant to a particular debtor can be accessed, and that conversion between the different types of proceedings can be achieved.

414 *Insolvency Act* 2015:sec. 318(4).

415 *Richter v Absa Bank Limited* (20181/2014) [2015] ZASCA 100 (01 June 2015).

416 *Richter v Absa Bank Limited* 2018, par. 15. It takes little to imagine instances developing, after the issue of the final order, that could lead to the circumstances of a company improving radically, such that it would become profitable if allowed to trade. It could be awarded a contract for which it had earlier tendered or secure funding for future projects; a major creditor might indicate a willingness to subordinate its claim. Accordingly, in the scheme of things, where, during liquidation, evidence becomes available that business rescue proceedings will yield a better return for shareholders and creditors and jobs will be retained, there could be no reason to deny business rescue only because a company is in final liquidation. Indeed, to allow it to do so would fall into the very scheme of business rescue envisaged by the Act and fulfil the objectives of providing for revival of a financially distressed company with all its attendant social benefits.

The application for an expedited voluntary arrangement is made to the official receiver[417] and should be accompanied by a financial statement setting out the debtor, creditors, debts, assets and liabilities.[418] If the official receiver is convinced that there are reasonable prospects that the debtor's proposal will be approved, it invites creditors[419] to accept or reject it.[420] In making arrangements for the creditors' meeting, the official receiver should make sure that each creditor is informed of the official receiver's criteria to classify creditors.[421] Unlike a voluntary arrangement, the procedure for expedited voluntary arrangement does not allow creditors to modify the debtor's proposal.[422]

3.5.1.2 Approval of expedited voluntary arrangement

The debtor's proposal is approved or rejected at the creditors' meeting.[423] After the creditors' meeting, the official receiver needs to report the outcome of the meeting to the court. If the creditors accept the debtor's proposal, the court will approve it as a voluntary arrangement.[424] An expedited voluntary arrangement binds the debtor and every creditor who was entitled to vote at the creditors' meeting.[425] It is posited that an expedited voluntary arrangement is a hybrid procedure as contemplated by the World Bank Report on out-of-court debt restructuring schemes.[426] A hybrid procedure begins

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417 *Insolvency Act* 2015:sec. 316(2).

418 *Insolvency Act* 2015:sec. 316(2)(b)(i). The debtor may submit to the official receiver– (a) a document setting out the terms of the debtor's proposal; and (b) a statement of the debtor's financial affairs containing– (i) such particulars as may be prescribed by the insolvency regulations for the purposes of this section of the debtor's creditors, debts, other liabilities and assets; and (ii) such other information as may be so prescribed."

419 *Insolvency Act* 2015:sec. 316(4) (4). "For the purposes of subsection (3), a person is a creditor only if– (a) the person is a creditor of the debtor in respect of a bankruptcy debt; and (b) the official receiver is aware of the person's claim and the person's address."

420 *Insolvency Act* 2015:sec. 316(3).

421 *Insolvency Act* 2015:sec. 316(5).

422 *Insolvency Act* 2015:sec. 316(5)(c).

423 *Insolvency Act* 2015:sec. 316(3), read with sec. 317. As soon reasonably practicable after the arrangements under sec. 316 have been implemented, the official receiver shall report to the Court whether the proposed voluntary arrangement has been approved or rejected.

424 *Insolvency Act* 2015:sec. 318(1).

425 *Insolvency Act* 2015:sec. 318(1)-(2). "If the official receiver reports to the court that the debtor's proposal has been approved, the proposal takes effect as a voluntary arrangement. (2) On taking effect as a voluntary arrangement, the proposal binds- (a) the debtor; and (b) binds every person (including a secured creditor and a preferential creditor) who was entitled to participate in the arrangements made in accordance with section 316(3), as if each of them were a party to the arrangement."

426 World Bank Report 2011:3. In numerous insolvency systems, there is no clear dividing line between formal insolvency proceedings and informal restructuring processes. This distinction is blurred with the introduction of workouts that are strengthened by contractual or statutory provisions ("enhanced restructurings") or by different mechanisms that seek to combine the advantages of both formal and informal approaches to indebtedness problems ("hybrid procedures"). In this way, informal and formal procedures find points of contact, and formality becomes a question of degree. In reality, the treatment of indebtedness problems can

as an informal procedure and ends up in the courtroom, only if necessary. The main advantage of this approach is that creditors and the debtor can discuss alternatives to bankruptcy. If the majority votes for the proposed new arrangement, dissenting creditors are bound by the majority decision.[427] The court intervenes by nullifying any bankruptcy orders against the debtor.[428]

Concerning creditors with voting rights, section 316(5) of IA 2015 does not classify creditors. Instead, the section requires that each creditor be provided with a copy of the debtor's proposal. The official receiver should further provide each creditor with information about the official receiver's criteria to determine whether the creditors approve or reject that proposal. When dealing with small businesses such as sole proprietorships and partnerships in financial distress, it is recommended that the first principle of INSOL International be considered.[429] According to this principle, multiple creditor workouts such as a voluntary arrangement should ideally apply to all creditors whose cooperation (vote) is required for any successful rescue attempt.[430] However, it is usually advantageous to limit the number of participants to the minimum needed to rescue a debtor in financial distress.[431] Before deciding which creditors in the affected classes are included, it is necessary to identify the classes of creditors involved in the process. These may include suppliers, creditors, credit insurers, and others involved in credit provision or management.[432]

One should keep in mind that alternatives to bankruptcy are meant to assist the debtor and at the same time serve the interest of the creditors. For this reason, creditors or any affected person[433] may make an application to the court objecting to the approval of the proposal.

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be represented by a continuum, with informal workouts at one extreme and formal insolvency proceedings at the other.

427 *Insolvency Act* 2015:sec. 318(1)-(2).

428 *Insolvency Act* 2015:sec. 318(4).

429 INSOL International 2017:6.

430 INSOL International 2017:6.

431 INSOL International 2017:6.

432 INSOL International 2017:6.

433 *Insolvency Act* 2015:sec. 314(2). "The persons who may make an application for the purposes of subsection (1) are– (a) (b) (i) (ii) (c) the debtor; a person who was entitled to vote at the creditors' meeting, or would have been so entitled if the person had had notice of it; the provisional supervisor or, if the proposal has taken effect as a voluntary arrangement, the supervisor of the arrangement; and (d) if the debtor is an undischarged bankrupt – the bankruptcy trustee in respect of the debtor's estate or the official receiver."

Section 314 provides two grounds upon which the creditor may object to the approval of the proposal: If the proposal unfairly affects the interests of the concerned creditor[434] and if a material irregularity occurred at the creditors' meeting. The first ground points to the need to consider the interests of creditors. Although the interests of creditors are not the central theme of alternatives to bankruptcy, they are still indispensable to a fair procedure. This coincides with the view that one of the objectives of the insolvency law is to maximise value for creditors.[435] On that note, the court is empowered to revoke an expedited voluntary arrangement because it is unfair to creditors or a material irregularity occurred during the creditors' meetings.[436]

3.5.1.3 Discharge under the expedited voluntary arrangement

The major demerit against the expedited voluntary arrangement is that it does not guarantee discharge for the debtor. Section 312(3), read with section 315 of IA 2015 provides that the debtor should remain under supervision until all debts and liabilities are discharged. [437] This suggests that a sole proprietorship that applies for a voluntary arrangement or expedited voluntary arrangement may remain under supervision throughout the owner's lifetime.

I suggest that a debtor should be discharged in cases where a substantial amount of administrative and operational expenses have been paid. According to Chapter 13, the purpose of applying for alternatives to bankruptcy is that the debtor should be able to borrow again towards the end of the process.[438] Hence, long-term expenses such as medical bills, especially for chronic diseases such as diabetes, and maintenance should not impede discharge. The legislature in Kenya may borrow principles applied in a Chapter 13 reorganisation scheme for sole proprietorships. Section of the Code provides three classes of debts that must be considered as "dischargeable".[439]

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434 *Insolvency Act* 2015:sec. 314(1)(a).

435 Jackson 1982:sec. 857; see also; Finch 2009:29; Korobkin 1991:762, 1993:555. For a contrary view, see also Finch 2009:31.

436 *Insolvency Act* 2015:sec. 320(1).

437 Mabe 2019:22.

438 In *Local Loan Co. v Hunt*, 292 U.S. 234 (1934): 244, The Supreme Court stated that the purpose of bankruptcy was to give the debtor "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt". See also Boraine & Roestoff 2002:1-11; Gross 1986:59-75; Richard 1980:843-866; Van Apeldoorn 2008:57.

439 *Bankruptcy Code* 1978:sec. 1328.

3.5.2 Summary instalment orders

A summary instalment order is defined as an order issued by the official receiver instructing the debtor to satisfy its obligations in instalments where it is practical and possibly considering the debtor's circumstances.[440] The discussion below explores this procedure in detail.

3.5.2.1 Commencement

A debtor or creditor can apply to the official receiver for a summary instalment order.[441] If a creditor makes the application, section 324(b) states that the debtor's consent must be acquired.[442] This section suggests that a creditor may not compel a debtor to be subject to a "compulsory summary instalment order". In other words, the summary instalment order cannot be entered if the debtor voluntarily applies or consents to it. The legislature in Kenya averted issues of peonage by allowing creditors to apply for a summary instalment order only with the debtor's consent. With the debtor's consent, it may be difficult to prove that the debtor is being subjected to involuntary slavery, as in Chapter 13 of the US Bankruptcy Code. In its rescue scheme, South Africa can follow the Kenyan approach to avoid compulsory provisions being declared unconstitutional for subjecting debtors to servitude or peonage.

However, IA 2015 does not specify whether the debtor should consent verbally or in writing. I believe that the debtor's consent should be in writing because a summary instalment order creates new obligations on the debtor. For instance, if the debtor defaults on payments, the creditors may commence bankruptcy proceedings.[443] Nevertheless, it is clear that without the debtor's consent, a creditor's application should not be approved.

This poses an important question: What is consent for purposes of obtaining a summary instalment agreement? To answer this question, I assume that a summary

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440 *Insolvency Act* 2015:sec. 323. "A summary instalment order is an order made by the Official Receiver directing the debtor to pay the debtor's debts– (a) in instalments or in some other way; and (b) in full or to the extent that the official receiver considers practicable in the particular circumstances of the case."

441 *Insolvency Act* 2015:sec. 323, 324.

442 *Insolvency Act* 2015:sec. 324(b). "The Official Receiver may make a summary instalment order on the application of a creditor with the debtor's consent."

443 *Insolvency Act* 2015:sec. 335(2)(b). "While a summary instalment order has effect, a person may not begin or continue proceedings against the debtor unless– (a) the Official Receiver gives approval for a creditor to begin or continue the proceedings; or (b) the debtor is in default under the order."

instalment order is a statutory agreement between the debtor and its creditors. In terms of this agreement, the debtor voluntarily undertakes to make payments in accordance with the order. Hence, consent must be understood from a contractual point of view. Under contract law, for consent to be valid, it must have been issued by a person with the required capacity.[444]

When considering the debtor's application, the official receiver must be satisfied that the value of the debtor's assets is below five hundred thousand shillings[445] and that the debtor is unable to effect payment when the debt becomes due.[446] The official receiver must provide creditors and the debtor with the opportunity to make representation during the application process.[447] The official receiver may reject the application if the application does not comply with insolvency regulations, indicate that the debtor will make payment in full, state the total number of instalments to be made weekly or monthly, indicate the debtor's total earnings, and indicate whether the debts are secured. It appears that the standard "payment of debts in full" refers to the agreed debts as they appear on the instalment summary order and not the initial debt. For instance, a debtor may not be required to pay its debt in full if the creditor accepts to remove an interest rate

3.5.2.2 Moratorium in summary instalment orders

The summary instalment order has the effect of staying all legal proceedings against the debtor.[448] The moratorium is both legally and economically justified. From an economic point of view, creditors will be receiving a certain amount of the debt weekly or monthly. Thus, initiating legal proceedings against the debtor would cost the debtor. Legal proceedings disrupt the payment of creditors because the debtor would have to pay for legal costs. From a legal point of view, summary instalment orders depend on

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444 Contractual capacity concerns the competence of a natural person to create rights and duties by concluding a contract with another (natural or juristic) person or persons. Hutchison & Pretorius: 2012:149; Nagel 2011:7; *Rood v Wallach* 1904 TS 187 AT 201*; Conradie v Rossouw* 1919 AD 279 at 320.

445 *Insolvency Regulations* 2016: reg. 51. Take note that 500 000 shillings is equivalent to 67 000 rands.

446 *Insolvency Act* 2015:sec. 326(1); 326(l). "The Official Receiver may make a summary instalment order if satisfied that– (a) the debtor's total unsecured debts that would be provable in the debtor's bankruptcy do not exceed the amount prescribed by the insolvency regulations for the purpose of this section; and (b) the debtor is unable immediately to pay those debts."

447 *Insolvency Act* 2015:sec. 326(2).

448 *Insolvency Act* 2015:sec. 335(2), 335. "(1) In this section, 'proceedings', in relation to a debtor in respect of whom a summary instalment order has been made, means proceedings brought against the person or property of the debtor in respect of a debt that has been- (a) shown in the debtor's application for the summary instalment order; (b) included in the summary instalment order; or (c) notified to the supervisor."

the willingness of the debtor to labour and create income or revenue. Therefore, it is not necessary to drag the debtor to court for an issue he or she is already willing to resolve.

However, section 355(2) allows any affected party to commence or continue legal proceedings if the official receiver approves, and in cases where the debtor defaults in payments.[449] The legislature does not define the term *default*. A literal interpretation may encourage creditors to commence legal proceedings, even if the debtor defaults due to a minor error or delay.

The legislature in Kenya may derive lessons from the South African legislation on debt review provided in the *National Credit Act* of 2005. Section 86(10) provides that if a debtor under debt review (a procedure analogous to summary instalment orders) defaults, the creditor may give notice to terminate the debt review process to the debtor, the debtor, counsellor and the National Credit Regulator.[450] Furthermore, if the creditor wishes to enforce payment, the magistrate hearing the matter may reinstate the debt review under new conditions that the court may deem just and fair.[451]

The main lesson from South Africa is that if a debtor defaults, it is necessary for the affected creditor to communicate with the debtor. Generally, the debtor must be given a chance to cure its default. This idea is not foreign to Kenya's jurisprudence. In *Cyn Energy Company Limited v Synergy Industrial Credit Limited,*[452] the court stated that when a debtor has defaulted, the court may not issue an injunction restraining the creditor from exercising its power of sale. This would amount to interference with the contract between debtors and creditors. However, the creditor must have issued the required notices, including notifying the debtor of the default. Generally, when a debtor

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449 *Insolvency Act* 2015:sec. 335(2). "While a summary instalment order has effect, a person may not begin or continue proceedings against the debtor unless– (a) the Official Receiver gives approval for a creditor to begin or continue the proceedings; or (b) the debtor is in default under the order."

450 *National Credit Act* 2005:sec. 86(10). "If a consumer is in default under a credit agreement that is being reviewed in terms of this section, the credit provider in respect of that credit agreement may give notice to terminate the review in the prescribed manner (a) the consumer; (b) the debt counsellor; and (c) the National Credit Regulator, at any time at least 60 business days after the date on which the consumer applied for the debt review."

451 *National Credit Act* 2005:sec. 86(11). "If a credit provider who has given notice to terminate a review as contemplated in subsection (10) proceeds to enforce that agreement in terms of Part C of Chapter 4, the Magistrate's Court hearing the matter may order that the debt review resume on any conditions the court considers to be just in the circumstances."

452 *Cyn Energy Company Limited vs Synergy Industrial Credit Limited* (2014) eKLR. The decision was later referred to in *Brits Freighters Limited v Standard Chartered Bank (K) Ltd* [2018] Eklr.

defaults, the creditor should issue a notice to cure and give the debtor reasonable time to cure the default.[453]

3.5.2.3 Implementing a summary instalment order

The supervisor must send a notice of the summary instalment order to all creditors appearing on the debtor's applications.[454] Creditors who were left out in the debtor's application but managed to prove their claims against the debtor may elect to be included in the administration of the debtor's estate.[455] Nonetheless, such a creditor is only paid after all other creditors stated on the summary instalment orders have been paid.[456]

One of the lessons from this approach is that IA 2015 does not apply to a certain category of creditors. One of the problems with the South African NCA 2005 is that it only applies to a specific class of creditors.[457] Creditors who cannot exercise their rights in terms of NCA 2005 resort to sequestration proceedings in terms of IA 1936.[458] Therefore, South Africa should consider rescue legislation that allows all creditors to levy their claims against the debtor. Nevertheless, in cases where the debtor fails to pay instalments in terms of the summary instalment order, it is presumed that the debtor was able to pay from the date of the order but decided to default. All legal proceedings against the debtor resume, and the supervisor is obliged to inform the official receiver.[459] It is accepted that not all debtors can be rescued and at some point creditors have to exercise their rights against the debtor. IA 2015 allows creditors to

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453 In *Ulla-Maija, Inc. v Kivimaki*, 2005 WL 2429490 (S.D.N.Y. 2005):4. At its most basic, a notice to cure must be specific enough to give the other party a reasonable opportunity to cure the alleged breach or default. See also *Pacifica L 51 LLC v. New Investments Inc.* (*In re New Investments Inc*.), 840 F.3d 1137 (9th Cir. 2016).

454 *Insolvency Act* 2015:sec. 336. The supervisor shall be liable to a fine should the notices not be sent, without reasonable excuse.

455 *Insolvency Act* 2015:sec. 339(4). A person who becomes a creditor of the debtor after the order has been made, and who proves a debt before the supervisor, may elect to be included in the administration of the debtor's estate.

456 *Insolvency Act* 2015:sec. 339(5). If such a person so elects, the person may be paid a dividend under the order only after the creditors who became creditors of the debtor before the order was made and who have been included as a creditor in the administration have been paid under the order.

457 *National Credit Act* 2005: Chapter 4, Part D, provides debt relief schemes. However, section 78 of that Act provides that "(1) This Part does not apply to a credit agreement in respect of which the consumer is a juristic person."

458 *Investec Bank v Mutemeri* 2010 1 SA 265 (GSJ) 266C. See also Mabe 2019:1-34; Maghembe 2011:171-180; Van Heerden & Boraine 2009:22-61.

459 *Insolvency Act* 2015:sec. 341. "(1) A debtor who fails to pay an amount due under a summary instalment order is presumed, unless the contrary is proved– (a) to have been able to pay the amount from the date of the order; and (b) to have refused or neglected to pay it."

pursue an enforcement action when the debt relief process has failed. This balances the rights of creditors to enforce their claims against the debtor and the rights of the debtor's attempt to resuscitate their businesses.

3.5.2.4 Refinancing the debtor's business

A debtor who is subject to a summary instalment order may not acquire further credit of more than one hundred thousand shillings before all creditors are paid.[460] However, if debtors wish to obtain credit exceeding the prescribed amount, debtors must inform the credit providers that they are subject to summary instalment orders.[461] A debtor involved in economic activities as a sole proprietorship or a partner in a partnership may require additional financing during the rescue process.[462] It is assumed that new money contemplated in section 342 is provided on the basis of a security interest. However, IA 015 does not guarantee preferential rights for creditors who extend new credit for debtors. This approach may be a disincentive to creditors who may be willing to assist the debtor. To avoid overburdening the debtor with financial obligations arising from post-commencement financing, the supervisor may be vested with the authority to approve or disapprove the acquiring debt during the rescue process.

One of the essential expenses of implementing a summary instalment order is appointing a supervisor.[463] A supervisor is allowed to charge a fee for supervising the debtor.[464] In terms of section 329, the supervisor's remuneration may not exceed seven per cent of the value of the debtor's assets. [465] The Kenyan method of calculating the supervisors' remuneration has more advantages than the tariff system used in South Africa.[466] First, the seven per cent limit allows debtors with different

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460 *Insolvency Act* 2015:sec. 342.

461 *Insolvency Act* 2015:sec. 342(3). "If a debtor fails to disclose that it is subject to an summary instalment order, may be liable to pay a fine not exceeding one million shillings or imprisonment of not more than twelve months or both."

462 UNCITRAL 2005:113, par. 91. "To maintain its business activities, the debtor must have access to funds to enable it to continue to pay for crucial supplies of goods and services, including labour costs, insurance, rent, maintenance of contracts and other operating expenses, as well as costs associated with maintaining the value of assets."

463 *Insolvency Act* 2015:sec. 328. "An SIO [summar installment order] is not effective if it does not state a supervisor willing to guarantee the debtor's compliance."

464 *Insolvency Act* 2015:sec. 329 of the new Act. "The role of the supervisor is so important that it is punishable by a fine or termination if the supervisor does not provide the official receiver with documents relating to the debtor's conduct and administration of his estate within 7 days of the notice to do so." *Insolvency Act* 2015:sec. 329(2) of the new Act; reg. 69 of the *Insolvency Regulations*, 2016.

465 *Insolvency Act* 2015:sec. 329(2) of the new Act; reg, 69 of the Insolvency Regulations, 2016.

466 *Companies Regulations* 2011: reg. 128.

asset values to secure the services of the same supervisor. It is financially more feasible than the liberal tariffs of up to R15 000 per day that BRPs can charge.[467] Second, the supervisor's payment is guaranteed even if the rescue attempt fails. Furthermore, the appointment of a supervisor may be omitted if the official receiver deems it unnecessary. In such instances, the debtor and the official receiver will act as supervisors.[468]

3.5.2.5 Discharge under summary instalment orders

A summary instalment order may be effective for a maximum of three years,[469] but if extenuating circumstances exist and the supervisor accepts, the official receiver may extend the period to five years.[470] The supervisor, creditor, or debtor may apply to the official receiver for a variation summary instalment order. It may allow debtors to pay the install order over a shorter period, especially if they have received a lump sum of money from family or friends or as an inheritance.

I believe that three years are too long for a debtor to remain undischarged. The Legislative Guide states that "to ensure that the reorganised debtor has the best chance of succeeding, an insolvency law can provide for a discharge or alteration of debts and claims that have been discharged or otherwise altered under the plan".[471] This strategy promotes the sanctity of contracting by giving binding effect to debt forgiveness, cancellation, or adjustment agreed to in a business rescue plan. The principle ensures that the provisions of the plan will be complied with by dissenting the creditors' plan and those who did not participate in the proceedings. Additionally, it provides security to other lenders and investors that they would not be forced to compete with other creditors who have undeclared claims if the debtor is pushed to liquidate its business.

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467 *Companies Regulations* 2011: reg. 128.

468 *Insolvency Act* 2015: secs. 328(2)-328(3).

469 *Insolvency Act* 2015:sec. 332. "The payment of instalments under a summary order can be spread over a period not exceeding- (a) three years; or (b) if justified by special circumstances acceptable to the supervisor – five years."

470 *Insolvency Act* 2015:sec. 333.

471 UNCITRAL 2005:284, par. 14.

3.5.3 No-asset procedure

A debtor without realisable assets may apply for the no-asset procedure.[472] The debtor may initiate this procedure by applying to the official receiver through the prescribed form and attaching its financial statement.[473] Before the official receiver rejects or accepts the debtor's application, he must be satisfied that the debtor has no realisable assets and has not been previously subjected to the same procedure.[474] Furthermore, the debtor has not been previously declared bankrupt and has debts less than one hundred thousand shillings and not more than four million shillings. Last, the official receiver must be satisfied that the debtor does not have a source of income to repay the debts.[475]

The above synopsis of the requirements for a no-asset procedure suggests that it is not suitable for entrepreneurs, such as sole proprietorships and partnerships, for the following reasons. First, IA 2015 requires the debtor to have no realisable assets. Entrepreneurs must demonstrate that they have some form of security to acquire post-commencement finances. Second, the no-asset procedure is concerned with debtors without income or revenue,[476] whereas sole proprietorships and partnerships must at least generate some form of profit to motivate creditors to cooperate with the rescue endeavour. Third, business rescue is meant for debtors in financial distress but not for chronically ill businesses.[477] For these reasons, I believe that the no-asset procedure is not suitable for business debtors, but it is appropriate for consumer debtors. At present, there are no rescue schemes for business debtors (companies, partnerships and sole proprietorships) without assets.

There are various reasons for developing a rescue process for administering a business debtor with few or no assets.[478] First, a business rescue scheme can facilitate an exploratory investigation into the affairs of the debtor. The investigation

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472 *Insolvency Act* 2015:sec. 343; *Ecobank Kenya Limited v Francis Tole Mwakidedi* [2018] eKLR at 13.

473 *Insolvency Act* 2015:sec. 344(2).

474 *Insolvency Act* 2015:sec. 345.

475 *Insolvency Act* 2015:sec. 345(1)(e).

476 *Insolvency Act* 2015:sec. 345(1)(e). "The debtor does not have the means to repay any amount towards those debts."

477 In *Welman v Marcelle Props 193 and another* 2012] JOL 28714 (GSJ) par. 28. The court held that "business rescue proceedings are not for the terminally ill close corporations, nor are they for the chronically ill. They are for ailing corporations, which, given time, will be rescued and become solvent."

478 UNCITRAL 2005:61, par. 73.

may focus on the observance of fair commercial conduct and determine whether the debtor complies with standards of good governance. The Legislative Guides caution that "assets can be moved out of companies or into related companies prior to liquidation with no fear of investigation or the application of avoidance provisions or other civil or criminal provisions of the law".[479] Second, a business rescue scheme may provide a return for creditors where antecedent transactions can be avoided and as a means of investigating the conduct of the management of such debtors.[480] Third, a business rescue scheme for debtors with few or no assets may encourage entrepreneurial activity and responsible economic risk-taking by providing entrepreneurs a discharge and fresh start. I believe that a no-asset procedure for business debtors may prove beneficial to debtors and also creditors.

3.5.4 Summary

Since Kenya was previously colonised by England, its laws seem to follow the English blueprint. Nonetheless, IA 2015 provides a significant turnaround in the treatment of debtors. The first lesson from IA 2015 is that alternatives to bankruptcy should be incorporated in insolvency legislation. It appears that alternatives to bankruptcy within insolvency legislation avert interpretation issues and the need to harmonise the two legislation, especially when the debt relief scheme fails.

The second set of lessons is derived from expedited voluntary arrangements. The expedited procedure offers three major lessons. First, the debtor who has been declared bankrupt may avoid bankruptcy proceedings by converting the case to the expedited voluntary arrangement. Second, the official receiver may assist debtors who may not be able to afford an attorney. Third, the procedure allows creditors to decide whether it is in their best interests to accept or reject the plan. The creditors' participation in decision-making guarantees their cooperation, especially if they all vote for the approval of the debtor's proposal. Fourth, the procedure does not prohibit a debtor from continuing their business during the implementation of the procedure.

The summary instalment orders procedure also appears to be beneficial. Although the procedure does not guarantee the debtor's discharge, it suspends all legal proceedings against the debtor, including bankruptcy proceedings. The main

479 UNCITRAL 2005:61, par. 73.
480 UNCITRAL 2005:61, par. 73.

advantage of the summary instalment order procedure is that the legislature provided a determinable time frame for the debtor's discharge. Considering that debtors may have long-term debts such as a mortgage, it is appreciated that summary instalment orders can last between three and five years. After that, the debtor is discharged from all the qualifying debts. Debtors involved in businesses such as sole proprietorships may take advantage of the quarterly instalment arrangements instead of paying monthly or weekly payments. A debtor is also allowed to conclude credit agreements involving a determined maximum amount. Unlike NCA 2005, which prohibits the extension of creditors to debtors under debt review, the summary instalment order procedure in IA 2015 allows a debtor to borrow for the business. The no-asset procedure is also an innovative procedure that provides hope to the poor consumers in Kenya. This procedure allows any debtor in financial distress to apply for debt relief even though the debtor may not have assets to distribute to creditors. Although the no-asset procedure does not accommodate business debtors, I believe that it is a precursor of a new paradigm: business debtors also need a no-asset procedure.

3.6 CONCLUSION

The discussion in this chapter showed that a formal business rescue procedure is required to facilitate the rescue and possible rehabilitation of sole proprietorships and partnerships in financial distress. A rescue procedure scheme should have five basic features, namely a commencement procedure, a moratorium, a business rescue plan, a financing strategy, and a discharge procedure. The current Chapter 6 business rescue in South Africa is not suitable for UBEs. This is because the law related to sole proprietorships or partnerships is fundamentally different from the company law. The possible solution to this problem is mirrored in nine different rescue procedures from the United States, the UK and Kenya.[481] The comparative assessment showed that a commencement procedure for sole proprietorships and partnerships should identify persons authorised to commence business rescue. If a sole proprietorship is in financial distress, the owner is authorised to commence business rescue. In all jurisdictions, a sole proprietorship may not be compelled to commence business

[481] South Africa (1), Chapter 6 business rescue scheme. The United States (2), the chapter explains Chapter 13 as it applies to sole proprietorships and Chapter 11 sections that apply to partnerships. England (4), debt relief orders, individual voluntary arrangement, partnership administration orders and partnership voluntary arrangements. In Kenya (3), expedited voluntary arrangements, summary instalment orders and no-asset procedure.

rescue. Kenya provides a prudent approach to the involvement of creditors. A creditor who wishes to commence summary instalment orders for a debtor is required to obtain their consent. This approach avoids any allegations of peonage. However, if the debtor is a partnership, there are different approaches. In the United States, partners should vote for the commencement of a Chapter 11 business reorganisation, whereas in the UK, the administrator or trustee may commence partnership administration. This implies that in South Africa, a business rescue scheme for sole proprietorships should commence voluntarily. If creditors initiate the process, it appears that they require the debtor's consent.

It appears that a business rescue scheme should include a moratorium against creditors. A moratorium prevents creditors from commencing legal proceedings against the debtor. The moratorium for sole proprietorships in the United States protects even codebtors such as spouses and guarantors from the debtor's creditors. Pertaining to partnerships, the general rule is that the moratorium only protects the partnership. Nonetheless, partners are protected in exceptional situations if they show that the rescue attempt fails if creditors commence legal proceedings against them. The main disadvantage of the partnership administration process in the UK is that the moratorium only protects the partnership. The main lesson for South Africa is that a business rescue process needs to provide a moratorium that protects the debtor's estate against creditors. As for partnerships, the estate of the partnership must be protected, and since partners are liable for the debts and liabilities of the partnership, they must have some form of protection against partnership creditors.

The study also showed that a successful business rescue process depends on a comprehensive business rescue plan. In all jurisdictions, it appeared that the rescue plan must determine the treatment of secured and unsecured creditors. Furthermore, the rescue plan may determine whether the debtor requires additional funding, and the legislature may provide an incentive for creditors who extend finances for the rescue process. To encourage the participation of creditors, South Africa allows post commencement financiers to gain preferential rights. In the United States, the Chapter 13 debtor must demonstrate that the rescue plan is feasible and that there is disposable income or revenue that can be distributed to creditors. In a Chapter 11 reorganisation, partners continue to be liable, and the trustee may sue partners for contributions towards the rescue process. Generally, the success of a rescue plan for

sole proprietorships and partnerships depends on their contribution to the rescue process. The proposed business rescue for debtors in South Africa is intended to provide different strategies for the treatment of creditors and possible avenues of post-commencement finances.

The comparative assessment indicates that a rescue process should be designed to guarantee the debtor's discharge. The UK IA 1986 and the Kenyan IA 2015 have a notable strategy for the discharge of debtors. Although discharge may be difficult in Kenya, the procedure provides a time frame for a debtor to be released from the obligation to pay certain debts. In the UK, a debtor has up to one year to pay its debts before discharge. This is a considerable time frame, and the effect of discharge is that the debtor may resume trading and concluding credit agreements again. The following chapter discusses the institutional frame of these procedures.

Chapter 4
BUSINESS RESCUE PARTICIPANTS

4.1 INTRODUCTION

Business rescue and insolvency processes are more than just a set of laws; they are comprehensive procedures in which various role players implement legal and administrative policies and practices.[1] These actors, in turn, have cultural, institutional, disciplinary, and professional backgrounds that influence their work.[2] This chapter explores the question: *What are the roles of the debtor, business rescue practitioner, and the judiciary in ensuring that unincorporated business entities are rehabilitated?*

This chapter examines different institutional structures and interrogates the roles of each business rescue participant. The South African institutional structure is examined to ascertain whether the responsibilities of the board of directors can be the same duties and responsibilities for owners of sole proprietorships or partners in a partnership. In addition, whether the BRP's rights and powers in the CA 2008 can be simply replicated in the rescue of UBEs; more importantly, whether it is necessary to establish specialised business rescue and insolvency courts. To clearly understand the roles of each business rescue participant, the discussion is followed by an analysis of the same roles in the United States, the UK, and Kenya.

4.2 SOUTH AFRICA

This section evaluates the sustainability of allocating the same rights and duties of the participants in the Chapter 6 business rescue to the same participants in the rescue of UBEs. Furthermore, this section examines the role of the courts in overseeing the business rescue process. This section discusses the duties of the board of directors, the responsibility of the BRP and the role of the court in the Chapter 6 business rescue.

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1 Dirix 2014:38; Fletcher & Bob 2012:78.

2 Dirix 2014:38; see also Westbrook *et al* 2010: 203 states that: "In the field of insolvency there are two actors whose integrity and experience are central to the functioning of the insolvency system: judges and administrators." Fletcher & Bob 2012:78 submit that in each individual case the organisational structure should be assured, with which these authors mean "a country's insolvency governance system in an individual case (the allocation of functions between courts and liquidators, including the legal and operational relationships between them, base requirements to fulfil these actors' functions, including professional and ethical rules that apply to them on law and additional regulations) as well as a country's institutional system, merely related to the requirements to fulfil these actors' functions, including professional and ethical rules that apply to them."

4.2.1 Duties of the board of directors in business rescue

This section evaluates the role of the board of directors during business rescue proceedings. The examination focuses on the board of directors' duties to commence business rescue and appoint and cooperate with the BRP. Furthermore, the discussion considers whether these duties are compatible with sole proprietorships and partnerships.

4.2.1.1 Duty to timeously commence business rescue

According to section 76(3) of CA 2008, directors must exercise their powers and perform their functions in good faith and for a proper purpose in the company's best interests.[3] The performance of these duties is overseen by the duty of care, skill, and diligence.[4] If the company is in a financial crisis,[5] section 129 of CA 2008 empowers the board of directors to adopt a resolution authorising the commencement of business rescue.[6] This begs the following question: *Does the board of directors' failure to pass a resolution for business rescue constitute a breach of the duty of care, skill and diligence?*

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3 *Companies Act* 2008:sec. 76(3)(b). "Subject to subsections (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director (a) in good faith and for a proper purpose; (b) in the best interests of the company; and (c) with the degree of care, skill and diligence that may reasonably be expected of a person— (i) carrying out the same functions in relation to the company as those carried out by that director; and (ii) having the general knowledge, skill and experience of that director."

4 *Companies Act* 2008:sec. 76(3)(c); Cassidy 2009:384; Cilliers ***et al*** 2000:147;. For an in-depth analysis of section 76(3), see also Botha 2009:710; Bouwman 2009:513; Davis ***et al*** 2012:115; Cassim et al 2012:559; Du Plessis 2010:269; Esser & Delport 2011:453; Stein & Everingham 2011:245; as well as *Bristol and West Building Society v Mothew* [1996] 4 All ER (CA) 698 711.

5 *Companies Act* 2008: 128(f): "'financially distressed', in reference to a particular company at any particular time, means that (i) it appears to be reasonably unlikely that the company will be able to pay all of its debts as they fall due and payable within the immediately ensuing six months; or (ii) it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months". See also Hefer 2015:419.

6 The decision to initiate corporate rescue should be weighed against the various options available to the board of directors. If a business is experiencing financial difficulties, the board of directors may initiate business rescue or winding-up proceedings. According to section 129, the board of directors may initiate business rescue proceedings only if there are reasonable possibilities for its rescue or rehabilitation. It appears that the board of directors must have a legitimate reason for resolving to begin business rescue proceedings. In *Griessel and another v Lizemore and another*[6] where Spilg J stated that "the most obvious is the requirement that there must be a legitimate business purpose in resolving to place the company under business rescue". The court further held that Chapter 6 seeks to strike a balance between the interests of all parties involved, including creditors and employees. The manner in which it accomplishes this reveals an underlying requirement for good faith. More importantly, the requirement of good faith is specifically mentioned concerning a director who may be liable for costs under section 130(5)(c) if the directors' resolution placing the company under business rescue is set aside and he fails to demonstrate to the court that he acted in good faith in asserting that the company was financially distressed. The ruling in *Griessel and Lizemore* applies when the board of directors decides to initiate business rescue but does not address the situation where the board of directors decides not to pass a resolution to commence business rescue.

There is no explicit provision in the CA 2008 that assigns liability to directors for failing to initiate business rescue procedures on time. In *Panama Properties (Pty) Ltd and another v Nel*,[7] the Supreme Court of Appeal held that:

> The passing of a resolution to commence business rescue cannot readily be described as a procedural requirement. It is merely the substantive means by which the company may take that step. The board is under no obligation at all to take such a resolution, although, if it is financially distressed, it may be obliged to inform shareholders and creditors of the reasons for not doing so.[8]

From this decision, the board of directors is not required to initiate business rescue proceedings, but the board is required to justify its decision not to do so in terms of section 129(7). The relevant section provides that if the board of directors has reasonable grounds to believe that the company is financially distressed but has not adopted a resolution, it must serve a written notice to each affected person to explain their reasons for not adopting a resolution.[9] Section 129(7) is a safety net designed to protect creditors and affected persons.

Although directors are not required to commence business rescue if they continue to operate the business despite its deteriorating financial condition, they may be held liable for any loss or harm sustained by the company due to their actions. Section 22(1) of the CA 2008, when read with section 77(3)(b), requires the board of directors to refrain from trading recklessly or with the intent to defraud creditors.[10] Furthermore, section 22(1)(b) prohibits the company from continuing to trade if it is insolvent.[11] Consequently, a director may be held liable for any losses suffered by the company due to their assent to the conduct of business.[12]

The standard in section 129(7) of CA 2008 may apply to UBEs. However, it should be noted that if a sole proprietorship or partnership notifies its creditors that it is in financial

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7 *Panama Properties (Pty) Ltd and another v Nel* 2015 (5) SA 63 (SCA): par. 23.

8 *Panama Properties (Pty) Ltd and another v Nel* 2015: par. 23.

9 *Companies Act* 2008:sec. 129(7): If the board of a company has reasonable grounds to believe that the company is financially distressed, but the board has not adopted a resolution contemplated in this section, the board must deliver a written notice to each affected person, setting out the criteria referred to in section 128(1)(e) that are applicable to the company, and its reasons for not adopting a resolution contemplated in this section.

10 *Companies Act* 2008:sec. 22(1). "A company must not– (a) carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose."

11 *Companies Act* 2008:sec. 22(1)(b). "(1) A company must not (b) trade under insolvent circumstances."

12 *Companies Act* 2008:sec. 77(3)(b): "A director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having, (b) acquiesced in the carrying on of the company's business despite knowing that it was being conducted in a manner prohibited by section 22(1)."

distress and has decided not to initiate business rescue proceedings, the creditors may interpret the notice as an act of insolvency. According to section 8(g) of the IA 1936, a debtor commits an act of insolvency if he writes to one of his creditors that he is unable to pay his debts.[13] As such, creditors are allowed to apply for compulsory sequestration.[14] Considering that insolvency proceedings may interrupt the reorganisation attempt, the legislature needs to harmonise insolvency provisions and reorganisation proceedings.

4.2.1.2 Duty to cooperate with the business rescue practitioner

The BRP assumes the role of the board of directors.[15] Essentially, the BRP takes over the management of the company. In turn, directors are expected to collaborate with practitioners.[16] Section 137(2) of the CA 2008 provides that directors of a company in business rescue must continue to perform as a director subject to the practitioner's authority.[17]

In practice, the CA 2008 requires directors to respond to the demands of the BRP and provide the practitioner with information about the financial and operational affairs of the company.[18] In addition, sections 142(1) and (2) require the board of directors to turn over all of the company's books and records in its possession. Directors are allowed to exercise any management function but must obtain approval from the BRP. Without such approval, their actions are void.[19] Furthermore, during business rescue

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13 *Insolvency Act* 1936:sec. 8g.

14 *Insolvency Act* 1936:sec. 9(1): "A creditor (or his agent) who has a liquidated claim for not less than fifty pounds, or two or more creditors (or their agent) who in the aggregate have liquidated claims for not less than one hundred pounds against a debtor who has committed an act of insolvency, may petition the Court for the sequestration of the estate of the debtor. Basically sequestration proceedings are instituted by a creditor against a debtor not for the purpose of claiming something from the latter, but for the purpose of setting the machinery of the law in motion to have the debtor declared insolvent."

15 Brinkley & Le Roux 2018:127: "Rescue proceedings take place over a short period of time and BRPs are under pressure of time constraints to fulfil each role successfully. This generally results in the BRPs spending most or all of their time involved with the rescue, leaving little or no time to dedicate to other role." See also Papaya 2014:29; Pretorius 2014:1-15; Pretorius & Holtzhauzen 2013:468-485; Van Niekerk & Smit 2016:34-35; Wilson & Harten 2019:38-39.

16 *Companies Act* 2008:sec.137.

17 *Companies Act* 2008:sec. 137(2)(a) and (b): "Each director of the company (a) must continue to exercise the functions of director, subject to the authority of the practitioner; (b) has a duty to the company to exercise any management function within the company in accordance with the express instructions or direction of the practitioner, to the extent that it is reasonable to do so."

18 *Companies Act* 2008:sec. 137(3): "During a company's business rescue proceedings, each director of the company must attend to the requests of the practitioner at all times, and provide the practitioner with any information about the company's affairs as may reasonably be required."

19 *Companies Act* 2008:sec. 137(4).

proceedings, directors remain bound by the requirements of section 75 of the CA 2008. That section requires the directors to disclose any person's financial interest to the board of directors.[20] Basically, when a company is in business rescue, the directors are no longer in control of the company.

It may be more difficult for the owners of UBEs to give up control of the business to the BRP. Most debtors are not familiar with business rescue, and even if the procedure is made available to them, some may be sceptical about cooperating with the BRP in fear of losing their business to the outsider. To resolve this issue, the debtor may remain in possession.[21] The term *debtor in possession* means that during restructuring proceedings, the debtor retains control of its business on a day-to-day basis, playing a role that a court-appointed or creditor-appointed third party would have filled.[22] The business rescue scheme for UBEs in South Africa should consider the *debtor in possession* approach for a number of reasons:

First, in many cases, the debtor will have a first hand and intimate understanding of its business and the industry in which it operates.[23] This knowledge is especially important in the case of sole proprietors and partnerships, and it may provide a basis for the debtor to play a role in making short-term and day-to-day management decisions in the interests of business continuity.[24] Second, it may also help the insolvency representative to perform its duties with a more immediate and complete understanding of the debtor's business operations. Third, the debtor is frequently in a strong position to propose a reorganisation plan.[25] In such cases, the total displacement of the debtor may not only eliminate an incentive for entrepreneurial activity, risktaking, and early commencement of business rescue, but may also undermine the reorganisation's chances of success.[26]

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20 *Companies Act* 2008:sec. 75. See also Bouwman 2015:27-28; Retief 2011:10-11; as well as *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited and another* [2015] JOL 33744 (WCC). The business rescue practitioner's duty to disclose personal interest was dealt with *Caratco (Pty) Ltd v Independent Advisory (Pty) Ltd* (Case no 982/18) [2020] ZASCA 17 (25 March 2020).

21 UNCITRAL 2021: par. 14. The insolvency law providing for a simplified insolvency regime should specify that, in simplified reorganisation proceedings, the debtor remains in control of its assets and the day-to-day operation of its business with appropriate supervision and assistance of the competent authority.

22 UNCITRAL 2005: par. 12.

23 UNCITRAL 2005:163 par. 5.

24 UNCITRAL 2005:163 par. 5.

25 UNCITRAL 2005:163 par. 5.

26 UNCITRAL 2005:163 par. 5.

Critics of this proposition could argue that it may expose creditors to unnecessary risk if the same debtor who piloted the business into bankruptcy, is left in control of the business. A well-balanced debtor-in-possession regime would address this concern. There are two approaches to solve this concern. First, the debtor may be required to submit regular reports to the creditors. The debtor can report on a weekly basis or monthly in the income statement and financial projects of the business. Second, instead of requiring the debtor to report to the creditors, a business advisor may be appointed to oversee and advise the debtor. This may only be effective if it does not overburden the debtor's estate. One should bear in mind that most UBEs are already undercapitalised and may not afford to pay the BRPs. As for the duties and responsibilities of the BRP, the following discussion explores whether they can be applicable to sole proprietorships and partnerships.

4.2.2 Duties and responsibilities of the business rescue practitioner

The central figure in galvanising the rehabilitation of a company in financial distress is the BRP.[27] A BRP is a person or two or more appointed to jointly oversee the administration of a company during the business rescue. After being appointed, the BRP is mandated to carry out his functions as provided in the CA 2008.[28] These functions include the power to develop and implement a rescue plan, take full control of the company's management, and monitor the affairs of the company with a view to rehabilitating the company.[29] The following sections explain the functions of the BRP during the business rescue and attempt to align these functions with the different principles of governance that apply to sole proprietorships and partnerships.[30]

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27 Brinkley & Le Roux 2018: 195; see also Conradie & Lamprecht 2018:1-12; Lamprecht 2008:183-196; Papaya 2014:29; Pretorius 2014:1-15; Pretorius 2014: 227-242; Pretorius & Holtzhauzen 2013:468-485; Van Niekerk & Smit 2016:34-35; Wilson & Harten 2019:38-39; as well as *Standard Bank of South Africa v The Master of the High Court* (Eastern Cape Division) [2010] 3 All SA 135 (SCA); *Booysen v Jonkheer Boerewynmakery (Pty) Ltd and Another* 2017 (4) SA 51 (WCC). The court held that the business rescue practitioner steps into the shoes of the board of the company and its management during the period when it is temporarily under supervision for the purposes of business rescue.

28 *Companies Act* 2008:sec.140.

29 Davis 2013:256. See also *Murgatroyd v Van den Heever NO and others* [2014] 4 All SA 89 (GJ) par. 17: The court held that the provisions of Chapter VI are not unduly prescriptive or restrictive as far as a practitioner's functions and duties are concerned. His functions and duties are broad and require a variety of steps to be taken. The nature of a practitioner's powers implies that he may in appropriate circumstances appoint advisors, valuators, auctioneers, forensic accountants, lawyers and other experts or persons to assist him in the carrying out of his plenary functions.

30 Mpofu *et al* 2018:20-26. This part contains a summary of submission from my previous work, which extensively explains the role of the *business rescue practitioner*.

4.2.2.1 Duty to manage the business of the company

The BRP's powers and responsibilities are divided into two categories, namely managerial and investigative powers. The BRP's function as the company's manager is stated and explained in section 140 of the CA 2008.[31] According to this provision, the BRP has complete managerial control over the company. In *Booysen v Jonkheer Boerewynmakery (Pty) Ltd,*[32] the court held that "the BRP steps into the shoes of the board of the company and its management". Legislation erased any doubts about the authority of the BRP over the board of directors by stipulating that the practitioner may delegate any power or function of the practitioner to a person who was part of the board or the pre-existing management of the company.[33] Furthermore, the BRP has the power to "hire and dismiss" members of the pre-existing board and management.[34]

However, if a BRP were to be appointed for a UBE, the idea of dismissing the directors and managers of the company may not be welcome. Most UBEs are owned and managed by one or two persons. Dismissing or even suspending the very founder of a sole proprietorship or the managing partner, has two consequences: it dissolves the business and adversely affects the goodwill of the UBE. Goodwill in this context means "the established reputation of a business regarded as a quantifiable asset and calculated as part of its value when it is sold".[35] The reputation of UBEs follows the entrepreneurs, and if the business is placed under business rescue, it may not be prudent to dismiss the entrepreneur. If the business depends on the experience and expertise of the entrepreneur, the BRP may be appointed to oversee the management of the business. The practitioner may temporarily suspend the entrepreneur as the director but keeps the entrepreneur as an executive director of the business. Considering that the entrepreneur will be well acquainted with the operational side of the business, this may serve the BRP while exercising his supervisory function.

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31 *Companies Act* 2008:sec. 140(1)(a).

32 2017 (4) SA 51 (WCC).

33 *Companies Act* 2008:sec. 140(1)(b)(c). UK *Insolvency Act* of 1986, Schedule B1, where it is provided that the "administrator of a company may do anything necessary or expedient for the management of the affairs of the company".

34 *Companies Act* 2008:sec. 140.

35 Ellis 2001:103-112; Negash 2003:23-40; Eloff & De Villiers 2015 found that there is an association between intangible assets, including goodwill, and the market value of the company to which it relates. The International Financial Reporting Standard 2004:3, 2004b, BC327, provided by a number of research studies that empirically examined the relationship between goodwill and the market value of business entities. Those studies generally found a positive relationship between reported goodwill of entities and their market values, thereby indicating that investors in the markets behave as if they view goodwill as an asset.

Another problem that emanates from replacing the partners with the BRP is that the BRP may not be able to carry out certain responsibilities. For instance, in a firm of doctors, the BRP will not be able to carry out the doctor's functions if he is not a qualified medical practitioner. Basically, the duties of directors during business rescue cannot be transferred to owners of UBEs without challenges.

4.2.2.2 Duty to investigate the affairs of the company

The BRP is required to investigate the financial affairs of the company.[36] Section 141 of the CA 2008 states that "as soon as practicable after being appointed, a practitioner must investigate the company's affairs, business property and financial situation".[37] Three aspects of this section may render the BRP's duty almost impossible: the time frame for investigations is very short; the scope of the investigation is too wide; and the Act does not provide a comprehensive list of the practitioner's investigative powers. For this reason, I believe that section 141 cannot be adopted for UBEs.[38] I am also of the opinion that the timeline within which the investigations must be conducted is too short. In terms of section 147(1),[39] read with section 148[40] of the CA 2008, the BRP is required to convene a meeting with the creditors and employees, informing them if there are reasonable prospects to believe that the company can be rescued. Furthermore, section 150(5) requires that the BRP publishes a complete business rescue plan within 25 days of appointment.[41] Essentially, the practitioner has a window of up to 10 days to assess the financial position of the company and 15 days to investigate the affairs of the company. Although the practitioner can apply to the court for an extension of time, the current time is very short. One could argue that UBEs are

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36 *Companies Act* 2008:sec. 141.

37 *Companies Act* 2008:sec. 141(1).

38 See discussion in 4.3.

39 *Companies Act* 2008:sec. 147(1)(1): "Within 10 business days after being appointed, the practitioner must convene, and preside over, a first meeting of creditors, at which— (a) the practitioner— (i) must inform the creditors whether the practitioner believes that there is a reasonable prospect of rescuing the company; and (ii) may receive proof of claims by creditors; and (b) the creditors may determine whether or not a committee of creditors should be appointed and, if so, may appoint the members of the committee."

40 *Companies Act* 2008:sec.148(1): "Within 10 business days after being appointed, the practitioner must convene, and preside over, a first meeting of employees' representatives, at which— (a) the practitioner must inform the employees' representatives whether the practitioner believes that there is a reasonable prospect of rescuing the company; and (b) the employees' representatives may determine whether or not an employees' committee should be appointed and, if so, may appoint the members of the committee."

41 *Companies Act* 2008:sec. 150(5): "The business rescue plan must be published by the company within 25 business days after the date on which the practitioner was appointed, or such longer time as may be allowed by— (a) the court, on application by the company; or (b) the holders of a majority of the creditors' voting interests."

usually smaller businesses, and it may be easier to carry out the functions in a short period. Nonetheless, the nature of the functions may require more time than the prescribed period. The BRP must investigate the affairs of the business and develop a business rescue plan at the same time. It is posited that these two main functions cannot be conducted effectively at the same time within a too short period of time.

The scope of the investigation is also too broad. According to section 141, the business practitioner must investigate whether the company has any prospect of surviving or whether liquidation proceedings are appropriate.[42] A further examination of the section also shows that the practitioner should investigate the company's dealings before business rescue. It involves determining whether some of the company's transactions were voidable or amounted to reckless trading, fraud, or a contravention of any laws.[43] The practitioner is also required to determine whether directors of the company have failed to discharge their duties and, where necessary direct them (relevant director) to ratify the defect.[44] Essentially, the scope of the possible contraventions is exceptionally wide and therefore imposes an enormous burden on the practitioner.

Considering the scope of the investigation and that the practitioner may not have the resources or expertise to conduct such an investigation, it becomes necessary to outsource and delegate. The practitioner may have to appoint private investigators, and this may prove to be expensive for UBEs. On that note, it becomes necessary to determine the practitioner's powers to investigate. The lead question in such a determination would be: *Is the Chapter 6 business rescue practitioner authorised to undertake an investigation akin to an insolvency inquiry in sections 414 and 415 or 417 and 418 of CA 1973?*

The answer seems to be negative, and the main reason for assuming this position is that the CA 1973 only applies where the company is in liquidation. A company in business rescue is for all purposes not yet in liquidation. Hence, the insolvency inquiry

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42 *Companies Act* 2008:sec.141(2)(a) and (b).

43 *Companies Act* 2008:sec. 141(2)(c): "If, at any time during business rescue proceedings, the practitioner concludes that there is evidence, in the dealings of the company before the business rescue proceedings began, of (i) voidable transactions, or a failure by the company or any director to perform any material obligation relating to the company, the practitioner must direct the management to take any necessary steps to rectify the matter; (ii) reckless trading, fraud or other contravention of any law relating to the company, the practitioner must (aa) forward the evidence to the appropriate authority for further investigation and possible prosecution; and (bb) direct the management to take any necessary steps to rectify the matter, including recovering any misappropriated assets of the company."

44 *Companies Act* 2008:sec.141.

in the CA 1973 does not apply in business rescue. This situation restricts the practitioner to the CA 2008, which only requires the directors to provide the practitioner with any material, information, books, or records on the company. With this information, the practitioner gains insight into the company's affairs without authorising an inquiry. The main loophole in section 142 is that it does not give the practitioner any authority to demand information from third parties who may have dealt with the company before it was placed under business rescue. Furthermore, it does not prescribe any powers of interrogation, subpoena, search or seizure by which the practitioner could ensure the accuracy of an assurance by the directors that all the company's books and records have been surrendered to the BPR. The matter becomes complicated if the rescue of UBEs were conducted under Chapter 6. The BRP's investigative powers may intrude on the owner's personal financial affairs. For instance, the practitioner may fail to interview or interrogate the spouses or life partners of sole proprietorships, since their evidence may be subject to spousal privilege.[45] Basically, the fact that the CA 2008 does not have specific areas for investigation may prove to be difficult for the practitioner to investigate a UBE.

4.2.2.3 Duty to develop and implement a rescue plan

The primary responsibility of the BRP is to oversee the development and implementation of the business rescue plan.[46] In *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd*,[47] the court observed that a business rescue plan should address the root cause of the company's demise and provide a remedy that has a reasonable prospect of resuscitating the company.[48] Such a

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45 *Criminal Procedure Act* 51/1977:sec. 198(1): "A husband shall not at criminal proceedings be compelled to disclose any communication which his wife made to him during the marriage, and a wife shall not at criminal proceedings be compelled to disclose any communication which her husband made to her during the marriage." Zeffertt et al 2003:619: "This privilege is founded on the notion that public opinion would find it unacceptable if spouses could be forced to disclose communication received from each other." See also Schikkard & Van der Merwe 2010:154.

46 *Companies Act* 2008:sec. 140(1)(d); Gootkin 2014:12-13.

47 Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd 2012 (2) SA 423 (WCC): par. 24.

48 Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd, par. 24. Such "concrete and objectively ascertainable details" as identified by the judge include the likely costs of rendering the company able to commence with its intended business or to resume the conduct of its core business; the likely availability of the necessary cash resource to enable the ailing company to meet its day-to-day expenditure, once its trading operations commence or are resumed. If the company will be reliant on loan capital or other facilities, one would expect to be given some concrete indication of the extent thereof and the basis or terms upon which it will be available; the availability of any other necessary resource, such as raw materials and human capital; the reasons why it is suggested that the proposed business plan will have a reasonable prospect of success.

mammoth task requires a person with profound expertise in business, economics or accounting, and more importantly, experience in the debtor's business. I believe that BRPs would be qualified to draft a business rescue plan for a sole proprietorship or partnership in financial distress; hence, it may not be necessary to create a new profession. However, considering that BRPs are expensive and most of the UBEs are undercapitalised, it may be necessary to establish an institution dedicated to facilitating the rescue process.[49]

Since, the Small Enterprise Development Agency is already dedicated to assisting small businesses,[50] it is recommended that the mandate of the Agency should be extended to include facilitating the restructuring UBEs in financial distress.[51] Section 10 of the National Small Business Act specifies that the function of the SEDA is to design and implement development support programmes in order to facilitate the promotion of entrepreneurship.[52] Furthermore, the Agency must "facilitate the creation of an enabling operating environment for small businesses".[53] It is argued that one of these programmes may include providing an institution that facilitates the rescue and recovery of small businesses in financial distress. The Agency is a suitable institution to facilitate a business rescue process for sole proprietorships and partnerships for the following reasons:

First, the Agency provides small businesses with business development and support services through its national network.[54] It also implements programmes to promote business development in areas the government has identified as a priority. Generally, this institution already has existing business networks and receives government assistance that may assist debtors in resuscitating their businesses. Second, the

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49 See discussion in 4.6.2.

50 Seda was established in December 2004, through the National Small Business Amendment Act 29 of 2004. The was established as an agency under the DTIC. The establishment was done by merging three organisations: Ntsika Enterprise Promotion Agency, National Manufacturing Advisory Centre (NAMAC) and the Community Public Private Partnership Programme (CPPP). The GODISA Trust and the Technology Programmes were integrated into SEDA in April 2006, becoming the Seda Technology Programme (Stp).

51 The *National Small Business Amendment Act* 29/2004:sec. 9A provides that "the objectives of the agency is to design and implement development support programmes; (b) promotes a service delivery network that increases the contribution of small enterprises to the South African economy, and promotes economic growth, job creation and equity; and (c) generally, strengthens the capacity of (i) service providers to support small enterprises; and (ii) small enterprises to compete successfully domestically and internationally.

52 National Small Business Amendment Act 2004:sec. 10.

53 National Small Business Amendment Act 2004:sec. 10.

54 National Small Business Amendment Act 2004:sec. 10.

Agency is responsible for assisting start-up businesses and has implemented an incubation programme to assist early entrepreneurs in their first year of starting the business.[55] Incubation has been shown to reduce the failure rate of small businesses during their first few years of operation.[56] Hence, the Agency has the necessary funding, expertise and structures that may prove beneficial in restructuring debtors in financial distress. Third, the Agency already has infrastructure throughout the country. There are 56 branches accessible to urban and rural business owners in all nine provinces. For this reason, it may not be necessary for the government to build or buy new properties to set up offices for business rescue. Instead, state-sponsored BRPs may be stationed in the already existing offices. The funding for state sponsored business rescue practitioners may take the form of legal aid. [57] The legislature may amend the NSBA Act 2004 to include provisions for the appointment of state-sponsored business rescue practitioners. In this way, small businesses may benefit from the expertise of business rescue practitioners without incurring any further expenses. If creditors are not satisfied with a state-sponsored practitioner, they may appoint one at their expense. Generally, the Agency is a neutral centre for debtors, creditors, and practitioners to meet and decide which procedure may best serve their interests. The following discussion delves into the involvement of the courts in business rescue.

4.2.3 Role of the court

The previous judicial management scheme was criticised for relying too much on the involvement of the courts.[58] However, the Chapter 6 business rescue process was

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55 SEDA Technology Programme Annual Review 2019:21-22.

56 SEDA Technology Programme Annual Review 2019:21-22.

57 *Legal Aid South Africa* Act 39 of 2014. The purpose of the Act is to The aims of Legal Aid SA are to: Give legal aid or to make legal aid available to indigent persons within its financial means. Provide legal representation at State expense, as set out in the Constitution of the Republic of South Africa, 1996 (the Constitution) and relevant legislation giving content to the right to legal representation at State expense. Provide education and information concerning legal rights and obligations.

58 Rajak & Henning 1999:268; see also Burdette 2002:345-347; Kloppers 2001:370; Levenstein 2016:60-61. The previous judicial management scheme was criticised for relying too much on the involvement of the courts. In terms of section 427, read with 428 of the CA 1973, the only way of commencing judicial management was to approach the courts for a provisional order and then follow up on the final order. Kloppers contended that considering these different proceedings, the cost of applying and running judicial management was not feasible. Thus, the need to approach the court may have deterred many companies from using the procedure. Rajak and Henning argued that this made the procedure expensive and not suitable for small and medium enterprises. The failure of judicial management stands as a proper guide for the legislature in promulgating any rescue schemes, especially for small and medium enterprises. The *Companies Act* 1973:sec. 428: states that “The Court may on an application under section 427(2) or (3) grant a provisional

consciously promulgated with an intention to distance the court from the process. In *African Bank Corporation of Botswana Limited v Kariba Furniture Manufacturers (Pty) Ltd and others,*[59] the court held that:

> there is a conscious attempt by the legislature, in chapter 6 of the Act, to keep the role of the court in business rescue proceedings to a minimum. Not only does this assist in making the business rescue process cost-effective, but it also allows for the swift and efficient rescue of the company within a period of three months from the start of the proceedings.[60]

The approach adopted by the legislature in Chapter 6 seems to keep the court on the sideline. I concur with Levenstein's[61] submission that the current business rescue procedure has kept the involvement of the courts to a minimum and add that the effectiveness of the courts during business rescue can be concretised by establishing specialised courts. The two sections below explain the duty of the courts during business rescue and the possibility of establishing specialised insolvency courts in South Africa.

4.2.3.1 Duty to safeguard the business rescue entry procedure

The Chapter 6 business rescue is designed to commence and terminate with minimum involvement of the court. As discussed in the preceding chapter,[62] there are two avenues for commencing business rescue: voluntary and compulsory business rescue. The option to commence business rescue by way of resolution reduces the court's involvement and makes voluntary business rescue more affordable and timeefficient. However, compulsory business rescue requires the involvement of the court. An affected person has to apply to the high court for an order compelling the debtor to commence business rescue. The court's primary duty is to ensure that only viable companies in financial distress are permitted to commence business rescue. Concerning UBEs, the court's main duty will be to determine whether a UBE has

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judicial management order, stating the return day, or dismiss the application or make any other order that it deems just." *Companies Act* 1973:sec. 427; Kloppers 2001:375-377. Burdette 2002:346 pointed that the courts saw judicial management as an extraordinary measure due to the fact that a creditor of a company that is unable to pay its debts is entitled to make use of liquidation in order to recover payment of his or her claims.

59 *African Bank Corporation of Botswana Limited v Kariba Furniture Manufacturers (Pty) Ltd & Others* 2013 (6) SA 471 (GNP).

60 *African Bank Corporation of Botswana Limited v Kariba Furniture Manufacturers (Pty) Ltd & Others* 2013: par. 51.

61 Levenstein 2016:293.

62 Chapter 3, sect. 3.2.1.1.

prospects of being rescued. Therefore, the court in South Africa is not significantly involved in business rescue.

4.2.3.2 Specialised business rescue and insolvency courts

When promulgating a business rescue scheme or insolvency legislation, it is necessary to decide whether the courts that will deal with any matter ensuing from the proceedings are state courts or specialised bankruptcy courts. The DTIC published guidelines to the legislature, which resulted in the promulgation of the current CA 2008. According to the Reform Guidelines, the legislature should consider setting up a dispute resolution mechanism to provide recourse to aggrieved shareholders.[63] Although the Reform Guidelines recommend that it may not be necessary to create a new institution for business rescue or insolvency, the CA 2008 authorises the establishment of designated judges. Section 128(3) of the CA 2008 provides that:

> the Judge President of a High Court may designate any judge of that court generally as a specialist to determine issues relating to commercial matters, commercial insolvencies and business rescue.[64]

In practice, the relevant judge presidents have not officially appointed any specialised judges to hear business rescue matters.[65] This approach is not surprising. Since the promulgation of IA 1936 and CA 1973, no specialised courts have been set up for judicial management or winding up. I assume that the legislature's intention in allowing the Judge President to appoint specialised judges is that judges have different areas of expertise. Where necessary, the Judge President should use his discretion to designate a judge to hear a business rescue matter.

I disagree with Levenstein, who applauds the current judgements as displaying a sound understanding of provisions in Chapter 6. There are numerous contradictory judgements,[66] and some judges, instead of exercising their quasi-legislative authority,

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63 Guidelines for Corporate Law Reform 2004:50. This policy paper sets out the framework and guidelines for more detailed technical consultation, which provided the foundation for the drafting of a new Companies Act.

64 *Companies Act* 2008:sec. 128(3).

65 Levenstein 2016:294.

66 For instance, in the case of *Advanced Technologies and Engineering Company Pty Ltd v Aeronautique et Technologies Embarquees SAS* Unreported case no 72522/ 20110 (GNP), the court held that section 129 required full compliance with the prescribed procedural requirements in subsection (3) an (4) and did not provide for the possibility of mere substantial compliance being sufficient or for condonation of non-compliance. Whereas, *in Exparte Van den Steen NO and South Gold Exploration (Pty) (Ltd)* Unreported case no 3624/2013 (WCC) the court held to the contrary. It held that substantial compliance with the notification requirements is allowed by section 6(9) of the Act. Compare the decision in *Oakdene Square Properties (Pty)*

blame the legislature for drafting errors.[67] Such judicial inconsistency and contradiction do not establish a significant precedent, and the law cannot be applied uniformly without precedent. I believe that these inconsistencies can be solved by establishing a specialised tribunal or court presided by judges with experience in business, financing, economics, and insolvency law.[68] The specialisation of the judiciary is seen as a way of solving three fundamental problems:

The first and most common problem is the *caseload crisis*. This term means the everaccelerating growth in the volume of cases coming before the courts, especially from lower courts to higher courts. Statistics South Africa states that by December 2020, more than 1 164 company liquidation proceedings were filed and finalised, and 1 852 individuals and partnerships filed for sequestration proceedings.[69] The South African Department of Small Business Development indicated that more than 42 per cent of small businesses would close by the end of the 2021 financial year due to the COVID-19 pandemic.[70] The one-week looting worsened the situation, resulting in a loss of more than 50 billion rands in gross domestic product.[71]

Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others [2013] 3 All SA 303 (SCA) par. 26. The court held that: "Although I have no problem with the dictionary meaning of 'rescue' and 'rehabilitation' on which the argument relies, it fails to recognize, I think, that s 128(1)(b) gives its own meaning to these terms, which does not coincide with these definitions. As I understand the section, it says that 'business rescue' means to facilitate 'rehabilitation', which in turn means the achievement of one of two goals: (a) to return the company to solvency, or (b) to provide a better deal for creditors and shareholders than what they would receive through liquidation. This construction would also coincide with the reference in s 128(1)(h) to the achievement of the goals (plural) set out in s 128(1)(b). It follows, as I see it, that the achievement of any one of the two goals referred to in s 128(1)(b) would qualify as 'business rescue' in terms of s 131(4)." A contrary decision was held in AG *Petzetakis International Holdings Ltd V Petzetakis Africa (Pty) Ltd And Others (Marley Pipe Systems (Pty) Ltd And Another Intervening)* 2012 (5) SA 515 (GSJ) par. [12]. JP Coetzee AJ stated that "[i]n my view the status of the alternative object in the South African Companies Act depends primarily on an interpretation of that Act. The creation of the alternative object will probably give rise to more litigation. It is, for example, strange to create an object for a new remedy in a definition section."

67 *Tyre Corporation Cape Town (Pty) Ltd and Others v GT Logistics (Pty) Ltd and Others* (Rogers J) [2016] ZAWCHC 124: par. 36. Rogers J pointed out that "[t]here may, however, be a different deficiency in the business rescue provisions of the Act. In the case of a s 155 compromise, creditors vote according to classes. The compromise must be approved by at least 75% in value of each class. In the case of business rescue, by contrast, the only requirement for approval is that the plan is supported by the holders of more than 75% of the creditors' voting interests actually voted and by at least 50% of the independent creditors' voting interests actually voted (s 152(2)). Section 131 does not confer on the court a power to create classes of creditors or to vary the provisions of the Act relating to the approval of plans. Nobody in the present case suggested that I had such a power. The absence of such a provision is anomalous, particularly since a plan which affects the rights of the holders of any class of the company's securities requires class approval (s 152(3)(c))." See also *Re ABSA Bank v Caine* NO [2014] ZAFSHC 46: paras 24-26; *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd:* par. 49, item 11.

68 See Chapter 4, sec, 4.6.

69 Statistics South Africa 2021: P0043 at 5 and 8.

70 Department of Small Business Development 2021:1.

71 Department of Small Business Development 2021:5. An estimate of 150 000 jobs on the risk, 50 000 informal traders affected, 40 000 small businesses and more than 200 shopping centers affected.

With these figures in mind, I foresee that the general courts will experience a high influx of business rescue and insolvency cases in the foreseeable future. Commentators have often proposed three possible approaches to addressing caseloads: directing cases to specialised tribunals, developing new processes for the expeditious disposition of large numbers of cases, or appointing extra specialised judges.[72] I suggest that the legislature should explore the possibility of establishing specialised tribunals with limited exclusive jurisdiction. This idea is not foreign to South Africa. There are already tribunals with limited jurisdiction specialising in specific areas, such as labour and tax courts.

The second problem that specialised courts can address is the need for expertise in increasingly complex areas of the law.[73] Legomsky stated that when the law is complex or the facts of the case are difficult for non-specialists to comprehend, utilising an expert judiciary improves both the quality of judgement and the quality of the law.[74] I consider business rescue and insolvency as a legal subject requiring a specialised court presided by an expert judge. To begin with, becoming an effective and efficient BRP requires a person well-informed in business, economics, financing, accounting and law. Commenting on the competencies of BRPs, Pretorius stated that teaching basic business management skills is not enough since enterprises in financial distress require more complicated skills than what an ordinary attorney can provide.[75]

The University of Pretoria recently introduced a master's degree in insolvency and business rescue aimed at professional accountants, lawyers, and business advisors who want to advance to the profession of BRPs. Some of the subjects include economics, business analytics and financing.[76] It is one thing for a lawyer to learn a

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72 Hruska Commission Report 1975:263. This was the basic proposal of the Hruska Commission, which was established by Congress to study the "structure and internal procedures of the Federal courts of appeal system".

73 See also Meador 1989:611-615. "The primary purpose of a nationwide subject matter jurisdiction, as distinguished from a regional appellate organization, is not to create a court of experts or specialists, but to maximize coherence and predictability in federal law through continuity and stability of decision makers." Yet even Professor Meador admitted that "one could structure subject matter jurisdiction so as to fit.", the label of specialised or expert court at 611.

74 Legomsky 1986:1388: "The dominant feature of a specialized court is the specialized subject matter of its cases. Most of the debate, predictably, has thus focused on the relative merits of specialist and generalist decisionmaking." See also Legomsky 2007:413-474.

75 Bradstreet 2010:195-213; Boyd 2011:36-43; Furnham & Mansi 2011:3-13; Pretorius 2014:227-242.

76 Pretoria University Programme Brochure 2021:5. The Module Financial Distress Assessment 822 (OBS 822): "The aim of this module is to equip students to explore modern research in corporate financial distress. Topics covered include financial distress identification and prediction, the link between distress and macroeconomic

new area of law, but expecting a lawyer to understand the formulas for econometrics, financial engineering, and business analytics is quite another. Hence, giving a specialised court authority over a complex body of law aids in addressing this difficulty. The judge can make decisions based on a solid understanding of a particular subject matter.

The third issue is that a specialised court addresses the problem of inconsistent decisions, which makes the law uncertain.[77] The rise of caseloads and increasing complexity in business rescue and insolvency will exasperate a non-uniform application and interpretation of insolvency legislation. Therefore, I recommend that the legislature should consider setting courts for business rescue and insolvency cases. These cases will include cases related to sole proprietorships and partnerships searching for debt relief.

4.2.4 Summary

The South African business rescue institution comprises the debtor, the BRP and the courts. The debtor is required to commence business rescue timeously. If the board of a financially distressed company decides not to commence business rescue, it should notify its creditors. This requirement may not be compatible with sole proprietorships or partnerships. Creditors of sole proprietors and partnerships may interpret failure to commence business rescue when the business is in financial distress as an act of insolvency. They may respond by applying for the compulsory liquidation of the business in terms of IA 1936. The debtor is also required to cooperate with the BRP. Most of the UBEs are not familiar with business rescue and the role of the BRP; hence, it may be necessary to educate debtors on the procedure.

The BRP is the main actor in business rescue. The position comes with many responsibilities, including stepping into the debtor's shoes by managing the business, investigating the financial affair of the business, developing a business plan, and overseeing its implementation. These duties, simply stated, can be complied with when the BRP is working with a board of directors. However, these duties cannot be

conditions, and financial bubbles. It also incorporates various tools from business analytics. The module covers business valuation in distress situations."

77 Jordan 1981:747: "Delay, uncertainty, and inconsistent decisions on difficult points of law in these areas represent real costs to society"; Revesz 1990:1116: "Supporters of judicial specialization maintain, first, that specialized courts will enhance the uniformity of decisions by eliminating review in multiple circuits under a legal regime in which there is no intercircuit stare decisis."

easily carried out if the debtor is a UBE. First, replacing the owner of a business means that the business has been dissolved. This undesirable consequence materialises if the BRP dismisses the entrepreneur behind the business (owner of a sole proprietorship or the managing partner in a partnership). Furthermore, most businesses operated by sole proprietorships and partnerships require the expertise of the owner. Thus, the practitioner cannot perform both managerial and operational duties; hence, replacing the owner may not be ideal for UBEs.

Second, the practitioner is required to investigate the debtor's business. The financial affairs of a UBE can be traced backed to the owner's personal financial affairs. The problem is that the CA 2008 does not outline the scope and limit of investigation. Hence, the BRP may be met with impediments such as spousal privilege. Third, BRPs are expensive, and it may be necessary to educate business owners on business or accounting to reduce the cost of hiring a BRP. The South African courts are more umpires than participants. They mainly safeguard entry to the business rescue by deciding whether an application by creditors to place the debtor in business rescue has the prospects of saving it from liquidation. Most of the court hearings are concerned with the application and interpretation of the CA 2008. The following section explores the different roles of the same participants in the United States business reorganisation scheme.

4.3 UNITED STATES OF AMERICA

This section assesses the role of sole proprietorships during the Chapter 13 business reorganisation and partners when the partnership has been admitted to Chapter 11 business reorganisation. The discussion is followed by examining the duties of trustees in Chapter 13 and the appointment of Chapter 11 trustees. The section concludes with a determination of the court's role in business reorganisation.

4.3.1 Duties of the sole proprietor during reorganisation

The idea that a sole proprietorship can apply for business rescue is foreign to South Africa. Hence, a determination of the role of the business owner is significant in promulgating business rescue legislation for such debtors.

4.3.1.1 Duty to operate the business effectively

When a sole proprietorship is under business reorganisation, the owner can continue operating the business in compliance with applicable laws.[78] Applicable laws in this context refer to any statutory or regulatory reporting that may apply to the debtor's business.[79] The debtor is expected to perform the duties of the trustee as provided under the *Bankruptcy Rule* 2015 (a)(4). One of these responsibilities is to notify the reorganisation attempt on all known parties in possession of property subject to withdrawal or order by the creditor. [80]

Although the debtor enjoys the right to continue operating its own business, such a right is not unfettered.[81] The court remains with authority to instruct the debtor to surrender its business to the trustee, mainly if it is operating at a loss. A debtor who continues to operate the business at a loss violates the provisions in the Bankruptcy Code. In the case of *In re Hull*,[82] the United States Bankruptcy Court, E.D. Oklahoma, held that "creditors must be adequately protected to compensate them for the declining value of collateral while the automatic stay is in place". Therefore, for the sake of creditors, if the debtor fails to make a profit, the court has the authority to convert the reorganisation case to a Chapter 7 case.[83] As opposed to a Chapter 13 bankruptcy, a Chapter 7 bankruptcy does not necessarily involve filing a repayment plan.[84] The

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78 Under Title 28 U.S.C.A., sec. 959(b), a "trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession must manage and operate property in her possession in accordance with applicable state law."

79 *In re Johnson,* 532 B.R. 53 (Bankr. W.D. Mich. 2015), the court ruled that the debtor could not continue to operate his medical marijuana business if he wanted to pursue relief under the Bankruptcy Code.

80 This may include banks, utility companies, landlords holding deposits, and insurance companies issuing a policy with a cash surrender value payable to the debtor.

81 *Bankruptcy Code* 1978:sec. 1304(b): "Unless the court orders otherwise, a debtor engaged in business may operate the business of the debtor and, subject to any limitations on a trustee under sections 363(c) and 364 of this title and to such limitations or conditions as the court prescribes, shall have, exclusive of the trustee, the rights and powers of the trustee under such sections."

82 *In re Hull*, 2010 WL 3168067 (Bankr. E.D. Okla. 2010).

83 *In re Hull*, 2010 WL 3168067 (Bankr. E.D. Okla. 2010*)*. See also *In re Goode*, 235 B.R. 584 (Bankr. E.D. Tex. 1999). "Chapter 13 debtor moved for authority to use creditor's cash collateral, and creditor moved to prevent such use. The Bankruptcy Court, Parker, J held that in ruling on debtor's motion for authority to use creditor's cash collateral, court should not focus on whether it is in best interest of debtor and secured creditor, but on whether debtor carries its burden of showing that its use of cash collateral will not reduce value of creditor's interest in property without providing adequate protection, i.e., the indubitable equivalent of creditor's interest in property."

84 The distribution of the estate's property is governed by Section 726 of the *Bankruptcy Code*. There are six classes of claims under 726, and each must be paid in full before the next lower class is paid anything. Only after all other classes of claims have been paid in full is the debtor paid. As a result, the debtor has little interest in the trustee's disposition of the estate assets, except for the payment of debts that are not dischargeable in the bankruptcy case for whatever reason. See also Terrence 2020:387.

bankruptcy trustee collects and sells the debtor's non-exempt assets, and the proceeds of the sale are used to pay creditors.[85]

In Chapter 13, the debtor is required to open and maintain a cheque account or other account during the course of business.[86] This requirement emanates from section 345 of the *Bankruptcy Code*, which requires all debtors under reorganisation to open a new account in connection with the continued operation of the business. The specific section requires any revenue generated by the debtor's business or estate to be insured or guaranteed by the United States or secured by a bond.[87]

There are three lessons from the first duty. The first is that the trustee does not take over the operation of a sole proprietorship as long as it generates profit. This approach gives the owner a second chance and protects the creditors from losing the business's value. Second, allowing the debtor to continue managing the business maintains its reputation and goodwill against any negative sentiments attracted by the stigma of bankruptcy. Third, opening a separate account for the business during reorganisation increases transparency and accountability. The effectiveness of these approaches is maintained by the duty to report to the trustee. This will allow the trustee to determine if the firm is generating a significant profit or is failing. In the event that it is not successful, the trustee may suggest to the creditors that they make an application to convert the proceedings into liquidation proceedings.

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85 When a Chapter 7 petition is filed, the United States trustee appoints an impartial case trustee to oversee the case and liquidate the debtor's nonexempt assets (*Bankruptcy Code* 1978: secs 701, 704). If all of the debtor's assets are exempt or subject to valid liens, the trustee will usually file a "no-asset" report with the court, and no distribution will be made to unsecured creditors. The vast majority of Chapter 7 cases involving individual debtors are no-asset cases. However, unsecured creditors must file their claims with the court within 90 days of the first date set for the creditors' meeting if the case appears to be a "asset" case at the outset Bankruptcy Rules 2015: rule 3002(c).

86 *In re Seger*, 444 B.R. 492, 495, 65 Collier Bankr. Cas. 2d (MB) 121 (Bankr. D. Mass. 2011). Chapter 13 trustee filed certificate of noncompliance and requested that debtors' Chapter 13 case be dismissed based on their alleged failure to maintain operating account for their business in appropriate depository institution. The Bankruptcy Court clarified that Chapter 13 debtors who engage in business do not have the same administrative obligation imposed on trustees to maintain bank accounts exclusively in depositories approved by the United States Trustee (UST); existing regulatory regime requires only that Chapter 13 business debtors maintain at least one checking account in bank, credit union, savings or other financial institution, and that checks issued on that account include reference to account holder as being a debtor and to docket number of Chapter 13 case.

87 *Bankruptcy Code* 1978:sec. 345.

4.3.1.2 Duty to report to the court and the trustee

As previously mentioned, the owner of the sole proprietorship performs the duties of a trustee as provided in section 704. This section requires a trustee who is managing the debtor business to file reports to the Bankruptcy Court as well as the US Trustee with "periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information".[88] The Chapter 13 debtor who engages in the business is also required to satisfy the reporting requirements. One of the incidents of this requirement is the duty to record receipts and disposition of money and property received.[89]

The purpose of this duty is to provide the trustee with information to assess the debtor's situation and make an informed recommendation to the Bankruptcy Court regarding confirmation issues. Such issues may include whether the debtor prepared and proposed the reorganisation plan in good faith and is feasible. For example, in the case of *In re Lilley United States Court of Appeals*, Sarokin J held that the "debtor's prepetition tax fraud was not cause for dismissal of the petition, but lack of good faith in filing is sufficient cause for dismissal of Chapter 13 petition".[90] Furthermore, the reporting is essential in determining whether the debtor is conducting business in the best interest of the creditors, filing all required tax returns or contributing all disposable income. This duty can best be described as the duty to cooperate with the trustee. It forces the debtor to disclose all material information before the court confirms the reorganisation plan. This approach safeguards creditors' interests and allows the debtor to continue operating its business without the interruption of legal proceedings by creditors who may apply to remove the moratorium.

88 *Bankruptcy Code* 1978:sec. 702.

89 *Bankruptcy Rule* 2015: 2015(c)(1).

90 *In re Lilley, United States Court of Appeals*, Third Circuit, July 31, 1996 91 F.3d 49178 A.F.T.R.2d 96-588465 USLW 213. In that case the Chapter 13 debtor filed a petition to discharge debts incurred as a result of debtor's willful failure to pay personal income taxes. The Internal Revenue Services filed a motion to dismiss the petition. The Bankruptcy Court 181 B.R 809 denied the Internal Revenue Services's motion. It appealed. The United States District Court for the Eastern District of Pennsylvania reversed the judgement but the debtor appealed. The Court of Appeal, Sarokin J held that tax liabilities that result from debtor's attempt to defraud government and from willful evasion are dischargeable under Chapter 13.

4.3.1.3 Authority to negotiate post-commencement finance

The owner of a sole proprietorship has the authority to exercise the trustee's right to obtain post-petition credit without the court's authority.[91] However, such credit must be obtained during the ordinary course of business and depends on whether it is secured or unsecured.[92] The typical application of this provision is to allow the debtor to incur debts related to the business, that is, debt classified as trade credit.

The debtor's authority to incur further debts is permitted as an administrative expense.[93] Hence, if the debtor cannot obtain unsecured credit, section 364 provides additional methods for the debtor to secure further financing by offering additional protection to the creditors.[94] First, the court may intervene by granting an administrative expense priority to the new credit agreement over the other administrative expenses.[95] Second, the court may allow the debtor to secure the loan with an unencumbered property of the business estate.[96] Although the debtor has the authority to obtain post-commencement finance, the courts monitor the conclusion of such new transactions. The impartiality of the courts is crucial since it has to balance the interest of creditors and the legislature's desire to reorganise the debtor in financial distress.

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91 *Bankruptcy Code* 1978:sec. 1304(b).

92 *Bankruptcy Code* 1978:sec. 364(a). See also *In re Caccamise*, 2009 WL 5205980, 3 (Bankr. E.D. Va. 2009) wherein the court permitted debtor-wife, a realtor, to retain the use of her credit card for business purposes and permissibly discriminate in favour of allowing her to pay the relatively low prepetition balance on the card.

93 *Bankruptcy Code* 1978:sec. 503(b)(1).

94 *Bankruptcy Code* 1978:sec. 364(c).

95 *Bankruptcy Code* 1978:sec. 364(c)(1).

96 *In re Nesser*, 206 B.R. 357 (Bankr. W.D. Pa. 1997), a creditor filed motion to revoke discharge granted to Chapter 13 debtor in a prior Chapter 7 case that had been converted from Chapter 11. Fellow shareholder and franchise filed motion to dismiss adversary proceeding filed in Chapter 13 case by debtor, who had 50% noncontrolling, nonmarketable interest in restaurant. Motions were filed to dismiss the Chapter 13 case or to reopen the Chapter 7 case and to permit debtor to incur additional credit. Objections were made to confirmation of debtor's Chapter 13 plan. The Bankruptcy Court, Fitzgerald, J held that: "(1) feasibility confirmation requirements were not satisfied for plan that relied on success of unopened pub, lawsuit as to which debtor might not be real party in interest due to its status as asset of Chapter 7 estate, and unrealistic value of debtor's interest in restaurant; (2) debtor's cause of action against fellow shareholder and franchise was property of the Chapter 7 estate, not the Chapter 13 estate; (3) use of equitable powers was appropriate to restore status quo ante, reopen Chapter 7 case, and vacate abandonment of stock, which debtor claimed entitled him to incorporate cause of action as asset of Chapter 13 estate; (4) debtor's failure to disclose cause of action in Chapter 7 case did not warrant revocation of discharge; and (5) debtor was not entitled to obtain credit to open pub. Generally, the provision is infrequently invoked, and such borrowing is rarely permitted, because its requirements are so stringent."

4.3.2 Duties of partners in Chapter 11 business reorganisation

A debtor in Chapter 11 is a debtor in possession, unless a party in interest applies for the appointment of an examiner or a trustee.[97] This statement suggests that when an insolvent partnership files for business reorganisation, it remains in charge of its business. It appears that an individual's rights and obligations are identical to the rights and obligations of an insolvent partnership.[98] However, partners in a partnership have unique responsibilities and duties during reorganisation. This part explores the partners' rights to manage the business and their obligations towards each other and towards the partnership. In brief, the general partners will continue managing the day-to-day business of the partnership, partners have a fiduciary duty towards the partnership, and most importantly, partners must contribute to the reorganisation of the business. The discussion below provides a detailed analysis of these duties and responsibilities.

4.3.2.1 Assumption of management rights

When a partnership is a debtor in possession, the general partners will continue to operate the partnership's business. The assumption of management rights occurs automatically. In the case of *In re Cardinal Industries,*[99] the limited partners applied for relief from the automatic stay to remove the general corporate partner. The movants argued that the trustee or the debtor in possession in Chapter 11 are distinct entities from the corporate partner. Therefore, they were entitled to remove the general partner and replace the partner based on their partnership contract. In terms of the partnership agreement, the relationship between partners is automatically terminated if the partnership files for business reorganisation.

The United States Bankruptcy Court, S.D. Ohio, Eastern Division, acknowledged that the partnership had dissolved but held that by applying for reorganisation in Chapter 11, the debtor's management interests as a general partner were not terminated.

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97 *Bankruptcy Code* 1978:sec. 1101(1); *Bankruptcy Rules* 2015: Rule 9001(5): "Although the DIP [Deptor in Possession] in a corporate Chapter 11 is the corporation itself for all practical, but not legal, purposes, the DIP is the management (partners, officers, directors, and so forth) existing as of the date the petition is filed."

98 The *Bankrupcy Code* 1978 provides two exceptions in sec. 522(b) and sec. 1141(d)(3), respectively. "First, the Code (and almost all state exemption statutes) does not allow a business entity (a corporation, partnership, joint venture, or the like) to claim exemptions. Second, an entity that is not an individual is entitled to receive a discharge in a Chapter 11 case if its plan does not provide for liquidation and if it continues in business after the consummation of its plan."

99 *In re Cardinal Industries, Inc.,* 116 B.R. 964, 973-84 (Bankr. S.D. Ohio 1990).

Furthermore, the separate entity theory is not applicable. The argument is ill-founded, not because the debtor and trustee are the same entities, but because the entity fulfilling the partnership agreement is identical to the entity that was a party to the original contract. Hence, there were no grounds for lifting the automatic stay.

In *Summit Investment & Development Corp v Leroux*,[100] the United States Court of Appeals, First Circuit, was called upon to decide whether the general partner's right to manage the partnership's business terminated when he filed for business reorganisation. Leroux, Curran and Summit were general partners in a limited partnership. The partnership agreement gave general partners exclusive authority to manage the partnership's affairs by majority vote. In this regard, Leroux was appointed as managing partner, granting him the authority to control the partnership's day-to-day operations. However, one of the partnership agreement's provisions was that if the general partners filed for bankruptcy, their interests would be converted to limited partnership interests. Unless all other partners consented, this conversion contractually prohibited a bankrupt partner from engaging in partnership management. Leroux and Curran filed for reorganisation under Chapter 11. Summit sought a judicial declaration that Leroux and Curran's interests in the partnership were terminated when they filed voluntary under Chapter 11.[101] The movant's application was based on section 23(4) of the *Massachusetts Limited Partnership Act*, which provides that a partner ceases to be a general partner of a limited partnership when they apply for a voluntary petition for reorganisation. Leroux and Curran argued that section 365(e) of the *Bankruptcy Code* 1978 pre-empts contractual and statutory provisions intended to terminate contractual rights in response to the debtor's application for reorganisation proceedings.[102]

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100 *Summit Investment & Development Corp v Leroux*, 69 F.3d 608 (1st Cir. 1995).

101 *Massachusetts Limited Partnership Act*:sec. 23(4): "Except as approved by the specific written consent of all partners at the time, a person ceases to be a general partner of a limited partnership upon the happening of any of the following events: Unless otherwise provided in writing in the partnership agreement the general partner: (i) makes an assignment for the benefit of creditors, (ii) files a voluntary petition in bankruptcy; (iii) is adjudicated a bankrupt or insolvent; (iv) files a petition or answer seeking for himself any reorganization, arrangement, composition, readjustment, liquidation, dissolution or similar relief under any statute, law or regulation; (v) files an answer or other pleading admitting or failing to contest the material allegations of a petition filed against him in any proceeding of this nature; or (vi) seeks, consents to, or acquiesces in the appointment of a trustee, receiver, or liquidator of the general partner or of all or any substantial part of his properties."

102 *Bankruptcy Code* 1978:sec. 365(e): "Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after

The United States Court of Appeals, First Circuit, held that the pre-emptive effect of *Bankruptcy Code* 1978, section 365(e), upon a partnership agreement is a question of understanding the legislative history of the provision. The court narrated that before the promulgation of the *Bankruptcy Act* 1978, unambiguous contractual terms such as the one that formed Belle Isle Limited Partnership were enforceable against Chapter 11 debtors, debtors in possession and their estates. Congress changed this approach in 1978 by enacting various sections, such as section 365(e) or 365(f), or 541(1), which invalidates contractual agreement *ipso facto* provisions.[103] The rationale for this decision was that automatic termination of a debtor's contractual rights frequently hampers rehabilitation efforts by depriving the Chapter 11 estate of valuable property interest at the very time the debtor and the estate need them most.

These two cases suggest that when a partnership files for business reorganisation, the partnership may be deemed terminated, but this does not mean that the partners' interests are extinguished. Hence, the managing partner is the *debtor in possession* and is entitled to continue managing the partnership business during reorganisation to benefit creditors and partners. The automatic stay prohibits the removal of the general partner even though the partnership agreement dissolves the partnership upon filing for reorganisation.

4.3.2.2 Fiduciary duty to the partnership and other partners

The general partners who will manage the affairs of the debtor in possession stand in the same position as the board of directors of a company with the same duties to the other partners and stakeholders.[104] In *Newburger, Loeb & Co. v Gross,*[105] partners in limited partnership requested a complete write-off of their outstanding contribution to the partnership as a condition of their consent to transfer partnership assets to

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the commencement of the case solely because of a provision in such contract or lease that is conditioned on (A) the insolvency or financial condition of the debtor at any time before the closing of the case; (B) the commencement of a case under Title 11."

103 House Report 1978:5845.

104 *KE Property Management v 275 Madison Management Corp.*, CA 12683, 1993 Del. Ch. LEXIS 147 (July 21, 1993).

105 *Newburger, Loeb & Co. v Gross,* 563 F.2d 1057 (2d Cir. 1977): "In a limited partnership, the general partner or partners have complete authority to deal with the partnership business and owe a fiduciary duty to the limited partners. As a general rule, limited partners do not have a fiduciary duty to the other partners in a limited partnership. *Chilglaze Farm v. Butz,* 485 F.2d 1125 (5th Cir. 1973); *Sommer v PMEC Associates & Co.*, 1992 U.S. Dist. LEXIS 11514 (S.D.N.Y. 1992). "However, a limited partner may be subject to the obligations of a fiduciary to the extent that the partnership agreement empowers the limited partner with discretion to take action affecting the governance of the limited partnership."

creditors. The United States Court of Appeals, Second Circuit, ruled that such actions amounted to self-dealing and a breach of their fiduciary duty to the retired general and limited partners whose capital remained in partnership and at risk of loss to the partnership's business. The debtor in possession requires some form of monitoring. It should be borne in mind that partners are also creditors of the partnership; hence, a conflict of interest already exists. Although they are under a fiduciary duty, the partners must regularly report to the trustee.

4.3.2.3 Duty to contribute towards reorganisation

The partners should contribute to the partnership reorganisation. According to section 18(a) of the *Uniform Partnership Act*, each partner must contribute towards the losses sustained by the partnership. Section 40(a) clarifies that after the dissolution of a partnership, the assets of the partnership are the contribution of the partners necessary for the payment of all partnership liabilities. In the event that there are outstanding debts, section 18 requires partners to pledge and deliver contributions to the partnership. In the case of *In Litchfield Co of South Carolina Ltd*[106] the court held that the partnership estate includes contributions of the partners necessary for the payment of all liabilities.

The trustee may sue partners for a contribution towards the reorganisation of the partnership. the case of *In re Madison Assocs v Baldante*,[107] the court held that section 723(a) does not preclude a Chapter 11 trustee from proceeding under section 544 to recover the deficiency of the estate's property from the general partners to pay the partnership debtors and creditors. Furthermore, *Commercial Bank v.Price (In re Notchcliff Assocs)*,[108] the Court held that a chose in action[109] under the *Uniform Partnership Act*, section 40(a), to obtain contributions necessary to pay liabilities passes to the partnership estate.[110] This action may also be enforced to the extent of

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106 *In Litchfield Co. of South Carolina Ltd Partnership v Anchor Bank (In re Litchfield Co. of South Carolina Ltd. Partnership),* 135 B.R. 797, 803-04 (W.D.N.C. 1992).

107 *Madison Assocs v Baldante (In re Madison Assocs.),* 183 B.R. 206, 215 n. 11 (Bankr. C.D. Cal. 1995).

108 *Commercial Bank v. Price (In re Notchcliff Assocs.),* 139 B.R. 361, 370-71 (Bankr. D. Md. 1992). See also *In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey*, 85 B.R. 13, 17 (Bankr. S.D.N.Y. 1988): The court denied motion for official general partners' committee; and stated that "creditors pursuing partners directly are in competition with the Chapter 11 Trustee's efforts to compel contributions for the benefit of all the Debtor's creditors."

109 In the case of *Torkington v Magee* [1902] 2 KB 427 a *chose in action* was defined as "personal rights of property which can only be claimed or enforced by action, and not taking physical possession".

110 *Backruptcy Code* 1978:sec. 541(a).

any deficiency of partnership assets over liabilities. The court held that this right passed to the trustee under Chapter 11 when the partnership reorganisation plan was confirmed. Requiring partners to contribute to the reorganisation of the partnership is an act of good faith and an incentive for post-commencement financiers who may be interested in assisting the partnership. Although the trustee may have a claim against the partners, it may save the partnership from legal costs if the partners voluntarily deliver their contributions to reorganise the partnership. This points to the trustee's involvement, who must make an effort to follow up on the debtors.

4.3.3 Office of the United States Trustee

Before the 1978 *Bankruptcy Code* was enacted, one of the most common concerns about the bankruptcy procedure was that bankruptcy judges were both managers and adjudicators of bankruptcy cases. To solve this problem, Congress created the Office of the United States Trustee and authorised the appointment of US trustees. The report of the House of Representatives points that the primary purpose of creating the US Trustee Office was to remove the bankruptcy courts from the administration of bankruptcy cases and focus only on adjudication.[111]

The United States Attorney General is authorised to appoint the Director of the Executive Office and US Trustees for all the regions in the state.[112] The US Trustees serve for a five-year renewable term[113] and has the power to appoint employees who can assist in the administration of bankruptcy cases. For the most part, the trustees' offices are centrally administered by the Executive Office of the US Trustees.[114] In terms of section 586 of Title 28, the duties of the US Trustees include establishing, maintaining, and supervising a panel of private trustees that are eligible and available to serve as trustees in cases under Chapters 7, 11, 12, 13, or 15;[115] taking special

111 House of Representatives 1977/95:95-5: "The primary purpose behind the creation of the office of the United States trustee [was] to remove the bankruptcy courts from the administration of bankruptcy cases."

112 Title 28, Part II, Chapter 39:sec. 581(a) setting out the 21 regions and specifying that the Attorney General shall appoint one United States Trustee for each of the following regions.

113 Title 28, Part II, Chapter 39:sec. 581(b). "Each United States trustee shall be appointed for a term of five years. On the expiration of his term, a United States trustee shall continue to perform the duties of his office until his successor is appointed and qualifies."

114 Title 28, Part II, Chapter 39:sec. 588 and 589.

115 Title 28, Part II, Chapter 39:sec. 589b(a)(1).

supervisory authority over the small business reorganisation under Chapter 11,[116] monitoring creditors' committees;[117] supervising as well as receiving periodic reports from the debtor in possession.[118] Basically, the work of the US Trustee is synonymous with that of the official receiver in the UK. They both focus on the administration of debtors who have filed for business rescue or bankruptcy. The section that follows explains the trustee's duties under the Bankruptcy Code. This discussion begins with an exploration of the different duties of the trustee in Chapter 13.

4.3.4 Role of the Chapter 13 trustee

The *Bankruptcy Code* 1978 requires that in each Chapter 13 case, a trustee be appointed to monitor the implementation of the business reorganisation plan.[119] It is important to note that Chapter 13 trustees do not take control or possession of the debtor's business. Neither are they obliged to liquidate the property of the estate[120] or file a reorganisation plan.[121] A casual observer would assume that a Chapter 13 trustee is appointed only to collect and distribute money to creditors. However, there are more responsibilities than being a disbursing agent. The trustee's involvement in a Chapter 13 case begins when the debtor files its application for an order to commence business rescue. As such, the trustee is almost involved in all the stages of a Chapter 13 case. This involvement means that the trustee must be highly knowledgeable on Chapter 13 practices in the district court. The trustee provides the court with an independent evaluation of the propriety of confirming the debtor's reorganisation plan; hence the trustee's views must be impartial, cogent and accompanied with a well-prepared report. The following sections explain these duties in detail.

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116 *Bankruptcy Code* 1978:sec. 1116. This section sets out special duties of trustee and debtor-in-possession in small business cases.

117 Title 28, Chapter 39:sec. 586(a)(3)(E).

118 Title 28, Chapter 39:sec. 589b(e).

119 *Bankruptcy Code* 1978:sec. 1302(a).

120 *Bankruptcy Code* 1978:sec. 704(a)(1). A Chapter 7 trustee has the duty to collect and reduce to money the property of the estate.

121 *Bankruptcy Code* 1978:sec. 1321. Only the debtor may file a plan. The trustee may, however, propose post-confirmation modifications to the plan in terms of Code 1329(a).

4.3.4.1 Duty to appear and advise the court

The trustee must appear in court for every matter concerning the debtor.[122] The main issues concerning the debtor's affairs include determining the property subject to a lien, confirmation of a reorganisation plan and modification of a post-confirmation plan.[123] Courts have, on several occasions, emphasised the importance of the trustee's appearance. In the case of *In re Kelsey*, the Bankruptcy Court held that "[t]he Chapter 13 Trustee has access to complete records regarding the accounting of a debtor's plan, and any determination by this Court without the Trustee's involvement would raise the possibility of presumptuous error."[124] For this reason, the trustee has the authority to appeal an adverse ruling against the debtor.[125]

The trustee is a custodian of the estate who advises the court on matters concerning the affairs of the debtor. In *re LaSota*,[126] the Bankruptcy Court held that "[t]he Trustee is the voice of the community, and that fact is why he or she is the representative of the estate".[127] As the representative of the estate, the trustee also serves the interest of all creditors. Therefore, the trustee's role during the confirmation of the debtor's plan is to ensure that the plan conforms to all provisions of the *Bankruptcy Code*.[128] For instance, if the debtor's reorganisation plan does not provide for a secured creditor's

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122 *Bankruptcy Code* 1978:sec. 1302(b)(2).

123 *Bankruptcy Code* 1978:sec. 1302(b)(2). *Waterfield Mortg. Co Inc. v Clark,* 31 B.R. 502, 506 (Bankr. S.D. Ohio 1983): "The Chapter 13 Trustee has access to complete records regarding the accounting of a debtor's plan, and any determination by this Court without the Trustee's involvement would raise the possibility of presumptuous error."

124 *In re Kelsey*, 6 B.R. 114, 117, 6 Bankr. Ct. Dec. (CRR) 927, 2 Collier Bankr. Cas. 2d (MB) 1192 (Bankr. S.D. Tex. 1980). "A debtor in involved in business filed Chapter 13 petition in bankruptcy. On a motion by the trustee to convert Chapter 13 proceeding to proceeding under Chapter 7 of the Bankruptcy Code, the Bankruptcy Court Patton, J held that: a Chapter 13 trustee has standing to request dismissal or conversion to Chapter 7 proceeding, particularly where debtor is one engaged in business. Furthermore, a Chapter 13 debtor's failure to timely file reports was not enough to justify conversion; and (3) debtor's noncontingent, liquidated, unsecured debts exceeded $100,000 threshold. Since the debtor was not entitled to bring proceeding under Chapter 13, proceedings would be dismissed, subject to debtor's motion to convert to proceeding under Chapter 11 or Chapter 7."

125 *Meyer v Pagano, Bankr. L. Rep*. (CCH) P 78747, 2002 WL 31159110 (N.D. Cal. 2002): Following entry of judgement of the United States Bankruptcy Court granting Chapter 13 debtor's discharge, the bankruptcy trustee appealed. The District Court, Chesney, held that a Trustee in bankruptcy had standing to appeal bankruptcy court's order granting Chapter 13 debtor's discharge in terms of sec. 704(6).

126 *In re LaSota*, 351 B.R. 56, 63 (Bankr. W.D. N.Y. 2006); *In re Kelsey*, 6 B.R. 114, 117, 6 Bankr. Ct. Dec. (CRR) 927, 2 Collier Bankr. Cas. 2d (MB) 1192 (Bankr. S.D. Tex. 1980): With these responsibilities imposed upon the Chapter 13 trustee, it is apparent that the trustee is likely to be the only person who would be able to completely report to the court on matters concerning the debtor's affairs.

127 *In re LaSota* 2006:63.

128 *In re Shelton*, 592 B.R. 193 (Bankr. N.D. Ill. 2018), the United States Bankruptcy Court, N.D. Illinois, Eastern Division held that Chapter 13 trustee has statutory right to be heard on all matters concerning a plan confirmation, without the need to establish a personal stake in the outcome of controversy, as required to establish standing.

claim[129] or fails to accommodate unsecured creditors,[130] the trustee has the right and duty to object to the confirmation of the plan. This duty does not mean that the trustee represents each creditor. Another instance where the trustee must object to the confirmation of a debtor's plan is when the debtor proposes paying excessive interest rates to a secured creditor.[131] Such a proposal has a negative impact on unsecured creditors. In *Till v* SCS Credit Corp,[132] the US Supreme Court held that the formula approach, requiring adjustment of the prime national interest rate based on the risk of non-payment, was an appropriate method for determining the appropriate interest rate on a cramdown loan. Therefore, a plan that fails to meet the *Till's* rate is improper, and the trustee is authorised to object.[133]

A significant aspect of the trustee's role in court is to determine the value of the debtor's property. The court requires the trustee to provide a liquidation analysis to ascertain whether each debtor will receive more than they would if the debtor's business is liquidated.[134] On this note, the trustee must be heard on matters that determine the value of the property subject to a lien.[135] In most instances, the debtor's property includes immovable property (the debtor's residence), motor vehicles, tools of trade and personal articles such as jewellery. Although the debtor may include the value of these items in its schedules, the trustee should make sure that each property has been fairly evaluated. If left unchecked, the debtor may overstate or understate the value of its property.

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129 *In re Andrews*, 49 F. 3d 1404, 32 Collier Bankr. Cas. 2d (MB) 1826, Bankr. L. Rep. (CCH) P76396 (9th Cir. 1995), the United States Court of Appeals, Ninth Circuit held that "Chapter 13 trustee had standing to object to confirmation of proposed plan under section 361 and 1325(a)(1) requiring plan to comply with provisions of Chapter 13 and with other applicable code provisions, based on trustee's contention that plan failed to comply with adequate protection requirement because creditors with smaller claims would not receive payments each month."

130 *In re Hill*, 268 B.R. 548, 47 Collier Bankr. Cas. 2d (MB) 81 (B.A.P. 9th Cir. 2001): "Trustee objected to debtor's proposed Chapter 13 plan, as being unfairly discriminatory. The Bankruptcy Court Jaroslovsky J, overruled objection and confirmed plan, on theory that it was merely discriminating, as specifically authorized under *Bankruptcy Code* 1978 , in favor of co-signed debt. Trustee appealed. The Bankruptcy Appellate Panel, Klein, J., held that: even assuming that debtor, as result of using her mother's credit cards to make certain purchases on her own behalf, had some enforceable obligation to mother to repay her for such charges, and even assuming that this debt qualified as consumer debt, mother was not, in any sense, a co-obligor 'liable with' debtor, under statutory qualification/exception to prohibition against unfair discrimination; and trustee had standing to appeal plan confirmation order."

131 *Bankruptcy Code* 1978:sec. 1325(a)(5)(B)(ii).

132 *Till v SCS Credit Corp* 541 U.S. 465, 124 S. Ct. 1951, 158 L. Ed. 2d 787, 43 Bankr. Ct. Dec. (CRR) 2, 51 Collier Bankr. Cas. 2d (MB) 642, Bankr. L. Rep. (CCH) P 80099 (2004).

133 *Bankruptcy Code* 1978:secs 1302(b)(2)(A); 1325(a)(1) and 1325(a)(5).

134 *Bankruptcy Code* 1978:sec.1325(a)(4).

135 *Bankruptcy Code* 1978:sec. 1302(b)(2)(A).

I believe that the problem of overestimating the value of the property may result in secured creditors receiving more than they are rightfully entitled to. Although this may silence the secured creditors during the confirmation hearing, it may prejudice the unsecured creditors as funds may run out to meet the claims of the secured creditors. Undervaluation poses two significant problems. First, an exaggerated evaluation may be used to mask the fact that the debtor's plan does not adhere to the requirement, namely "the best interest of creditors".[136] Second, it may result in a secured creditor receiving less than it would have received had the evaluation been just and fair. For this reason, the trustee must assess if the debtor's valuations are accurate and where the debtor "cooked" the valuations, the trustee is obligated to object. This view points at the inherent duty of the trustee to investigate the affairs of the debtor.

4.3.4.2 Duty to investigate the financial affairs of the debtor

The trustee's role in the Chapter 13 procedure includes investigating the financial affairs of the debtor.[137] Financial affairs in this respect include business and personal affairs. The trustee has the authority to investigate the debtor's acts, conduct, liabilities and financial matters concerning the business and personal life. More importantly, the trustee must examine whether the continuation of the business is in the best interests of the creditors.[138] In this regard, the trustee must compile a statement of investigations undertaken that should reflect any fraud, mismanagement, incompetence, misconduct, dishonesty or irregularity in managing the debtor's business and personal affairs.[139]

Even though the debtor is considered "engaged in business" in terms of section 1304, a trustee has the authority to request the debtor to provide its financial statements, income and expense report, profit and loss statement or monthly operating report, recent federal and state income tax returns, copies of all business licenses, bank deposits for payroll taxes and copies of insurance policies.[140] These documents provide the trustee with a complete picture of the debtor's financial affairs and conduct;

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136 *Bankruptcy Code* 1978:sec.1325(a)(4).

137 *Bankruptcy Code* 1978:sec. 1302(c).

138 *Bankruptcy Code* 1978:sec. 1106(a)(3).

139 *Bankruptcy Code* 1978:sec.1106(a)(4)(A); sec. 1106(a)(4)(B) indicates that the trustee is required to transmit a copy or summary of such statement to any creditors' committee, equity security holders' committee, indenture trustee, or any other entity the court designates.

140 Drake *et al* 2020: Chapter 17.3.

for instance, whether the debtor was indiscriminately using business accounts for personal expenses. The consistent and frequent reporting of the debtor's business is beneficial to both the trustee and the debtor. The trustee receives information that is crucial in assessing whether the debtor's business remains viable and profitable. In return, this will assist the trustee in consenting to the post-confirmation modification.

The trustee should also investigate the prepetition transactions between the debtor and third parties, including family, friends and even attorneys.[141] The purpose of the investigation is to prevent preferential treatment of unsecured creditors at the expense of other secured and unsecured creditors. The most prevalent issue in this regard is the attorney's fee. In terms of section 329 of the *Bankruptcy Rule* 2016, the bankruptcy court and the U.S Trustee are charged with enforcing appropriate legal fees. However, the courts have recognised that the trustee is better positioned to bring such a matter to the court's attention.[142] On several occasions, the courts have authorised the trustee to request the debtor's documentation regarding the attorney's fees and the scope of the attorney's mandate.[143] The court reasoned that the trustee's primary mandate is to preserve the value of the bankruptcy estate.[144] Therefore, the trustee has a legitimate interest in reviewing the appropriateness of an attorney's compensation.

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141 *In re Meyer*, 50 B.R. 3 (Bankr. S.D. Fla. 1985).

142 *In re Gonzalez Torres,* 14-09581 ESL, Docket No. 150, the court emphasised that a Chapter 13 Trustee has an independent duty to review documents pertaining to the compensation of debtors' attorneys or bankruptcy petition preparers. This review is necessary as part of investigating the debtor's financial affairs and claims against the estate. *In re Rodriguez Perez*, 2018 WL 3655656 (Bankr. D. P.R. 2018), the Chapter 13 Trustee challenged the "Validity of Contract for Bankruptcy Assistance and Amended Contract" pursuant to sec. 526-528. "The Trustee argued that the contract for bankruptcy assistance executed between the Debtor and her attorney was void for failure to comply with the material requirements of section 526-528. The Trustee challenged the validity of the contract due to the following: (i) the contract did not clearly and conspicuously explain the services that the attorney will provide to the debtor; (ii) the contract did not clearly and conspicuously explain the fees or charges for the services to be provided by the attorney; (iii) the contract was open-ended and did not provide a cap on the cost of the services". See also *In re Andreas*, 373 B.R. 864, 876 (Bankr. N.D. Ill. 2007); *In re Norman*, 2006 WL 3053309 (Bankr. E.D. Va. 2006).

143 *In re Norman*, 2006 WL 3053309, 6 (Bankr. E.D. Va. 2006).

144 *Barron v Countryman*, 432 F.3d 590, Bankr. L. Rep. (CCH) P 80408 (5th Cir. 2005): "Order was entered by the United States Bankruptcy Court for the Eastern District of Texas, requiring attorney that had represented debtors in various Chapter 13 cases to disgorge fees that he collected both pre- and post-petition. The attorney appealed. The District Court Crone, J affirmed. On further appeal, the Court of Appeals, Jones J held that: the Chapter 13 trustee had the standing to challenge payment system employed by bankruptcy attorney to collect fees from his debtor-clients; the retainer fee that attorney collected from debtors before the reorganisation petition to secure his legal representation was classified as 'advance payment retainer.' Such a payment became the attorney's property upon receipt and was not included in 'property of the estate'; but the attorney could be required to disgorge post-petition fee payments."

4.3.4.3 Duty to ensure that debtor makes timeous payments

Section 1302(b)(5) of the *Bankruptcy Code* 1978 provides that the trustee must ensure that the debtor pays its creditors. Payments must be made not later than 30 days after filing the Chapter 13 case. Although this duty appears elementary, a trustee was not expected to follow up on the debtor until the 1984 Amendments were adopted. Now, the trustee stands liable if he fails to monitor the performance of the debtor. If the trustee observes that the debtor is in arrears, the trustee should bring it to the court's attention during confirmation proceedings before the case is confirmed. If the court is not notified, the trustee may be held liable.

A literal interpretation of section 1302(b)(5) requires the trustee to ensure that the debtor commences with making payments but not monitoring the continuation of payments. If the debtor fails to continue making payments, it demonstrates that the reorganisation plan is not feasible or that the debtor is unwilling to cooperate with creditors. Consequently, the trustee may object to confirming the case on the grounds of lack of feasibility or good faith.

4.3.4.4 Duty to account for all property and money received for disbursement

According to section 704(a)(2), a Chapter 13 trustees are accountable for the property and money they receive from the debtors under reorganisation.[145] Since the debtor retains its property and the business during reorganisation, the trustee only receives money for disbursement to creditors.[146] The *Bankruptcy Code* provides several provisions on what the trustee must do when receiving money from a Chapter 13 debtor. The trustee has an obligation and authority to recover payments erroneously paid to creditors or disbursed to creditors out of order or if the court declares that the money does not belong to the creditor.[147] Because the trustee is a fiduciary and has duties of care and loyalty, he is responsible for the proper handling of funds entrusted to him, and he can be held personally liable for an improper payment if he does not recover the funds.[148]

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145 *Bankruptcy Code* 1978:sec. 1302(b)(1).

146 *Bankruptcy Code* 1978:sec. 322(a)(1).

147 *In re Nash*, 765 F.2d 1410, 13 Collier Bankr. Cas. 2d (MB) 209, Bankr. L. Rep. (CCH) P 70649 (9th Cir. 1985).

148 *In re Nash*, 765 F.2d 1410, 13 Collier Bankr. Cas. 2d (MB) 209, Bankr. L. Rep. (CCH) P 70649 (9th Cir. 1985): "Chapter 13 debtors brought action against trustee alleging that wage deductions had been wrongfully distributed by trustee after their first Chapter 13 case had been dismissed. The Bankruptcy Court granted

After confirmation, a trustee may have funds from the debtor's plan payments that creditors have not yet disbursed. When the debtor is entitled to a return of funds that the trustee is holding before confirming a plan, a creditor may seek to commence legal proceedings ordering the trustee to pay the creditor instead of the debtor.[149] Courts are divided on whether excess money should be returned to the debtor[150] or whether the trustee should hand it over to the creditors.[151]

Some courts held that the excess funds should be returned to the debtors. For instance, In the case of *In re Davis*,[152] the United States Bankruptcy Court, M.D. Alabama, held that, when a Chapter 13 case is confirmed or converted, the remaining money in the trustee's possession must be returned to the debtor. The court reasoned that this disbursement of funds serves several purposes. First, it promotes the policy of encouraging debtors who can repay their debts to file for Chapter 13. It guarantees that debtors who file for Chapter 13 will not be penalised for an unconfirmed filing. Returning the money to the debtor ensures that Chapter 13 cases are resolved efficiently and efficiently. Congress undoubtedly considered the possibility that creditors may want to share in the funds held by the trustee.[153] By requiring the trustee to return the funds to the debtor, Congress ensured that any attempts to obtain the funds would occur outside the bankruptcy court's jurisdiction.[154] As a result, unconfirmed cases may be closed as soon as legally possible after dismissal. On the

summary judgement for trustee and debtors' credit union and denied debtors' summary judgement motion. The United States District Court for the Northern District of California, Aguilar J., affirmed, and debtors appealed. The Court of Appeals, Cynthia Holcomb Hall, Circuit Judge, held that: (1) debtors' dismissal of their Chapter 13 case before discharge effectively vacated the plan confirmed in that case and therefore trustee was not required to continue making payments under that plan; (2) wage deductions received by trustee before dismissal of Chapter 13 case reverted to debtors upon dismissal and should not have been distributed by trustee to debtors' credit union after dismissal; and (3) trustee was liable for improper distribution of funds subsequent to dismissal of debtors' Chapter 13 case." See also *In re Morgan*, 353 B.R. 599 (Bankr. E.D. Ark. 2006); *In re Colvin*, 125 B.R. 182 (Bankr. E.D. Mich. 1991).

149 A creditor would not have this option in the event of conversion of the case because the automatic stay of Bankruptcy Code 2005:sec. 362(a) will still be effective to prevent actions to collect the debt from the debtor.

150 *In re Davis* 2004 WL 3310531, Bankr. (Bankr. M.D. Ala. June 16, 2004); *Department of Social Services, Division of Child Support Enforcement v Webb*, 908 F.3d 941 (4th Cir. 2018); *In re Pichardo Acosta*, 122 A.F.T.R. 2d 2018-5082, 2018 WL 3245174 (Bankr. D.P.R. 2018); *In re Locascio*, 481 B.R. 285 (Bankr. S.D. N.Y. 2012); *In re Sexton*, 397 B.R. 375 (Bankr. M.D. Tenn. 2008).

151 *In re Beam*, 192 F. 3d 941, 42 Collier Bankr. Cas. 2d (MB) 1717, 99-2 U.S. Tax Cas. (CCH) P 50917, 84 A.F.T.R. 2d 99-6555 (9th Cir. 1999). See also *In re Steenstra*, 307 B.R. 732, Bankr. L. Rep. (CCH) P 80078 (B.A.P. 1st Cir. 2004); *In re Cohen*, 2016 WL 797656 (Bankr. D. Ariz. 2016).

152 *In re Davis* 2004 WL 3310531, Bankr. (Bankr. M.D. Ala. June 16, 2004): par. 2.

153 *In re Davis*, 2004: par 2.

154 *In re Davis*, 2004: par 2.

contrary, there would be a “race to the trustee”, effectively ignoring the statutory mandate to return the money to the debtor.

A different approach was taken by the United States Bankruptcy Court, Arizona, *In re Cohen.*[155] In this case, the court held that section 1326(a)(2) is unclear. In some cases, a literal reading of this section would yield an absurd outcome. For example, section 1326(a)(2) requires a Chapter 13 trustee to restore all the remaining contributions of the plan should the court reject confirmation of the plan, even if the debtor intends to file an amended plan.[156] Furthermore, a literal interpretation of this section does not allow for the distribution of funds in every dismissed case. For example, if the debtor has been found incompetent, the trustee should not be expected to restore the remaining amount to the debtor alone but rather to the debtor’s guardian.[157]

The court further held that to fully appreciate the impact of section 1326(a)(2) on a debtor’s plan payments, this section should be examined in light of other Code provisions.[158] The filing of a petition for Chapter 13 relief creates an estate for the debtor that encompasses all of his property and prevents creditors from commencing legal proceedings. When an order for dismissal is docketed, the automatic stay is lifted, and the estate is dissolved. Section 349 of the *Bankruptcy Code* 1978 provides that, upon dismissal in the case of post-petition earning, the property “reverts” in the party having previous rights. Section 1326(a)(2) orders the trustee to repay these plan payments to the debtor if the debtor’s plan is not confirmed. If the debtor does confirm a plan, section 1326(a)(2) requires the trustee to carry out the plan’s provisions. While the *Bankruptcy Code* expressly and deliberately safeguards a debtor’s property, it makes no reference to the payments plan made upon dismissal for either unconfirmed or confirmed plans.[159] The court reasoned that returning any remaining funds to the debtor would likely encourage frivolous submissions and may enable the debtor to evade payment obligations.[160] A debtor may file for bankruptcy to avoid wage garnishment, neglect to prepare a financial plan, and then recover these funds from

155 *In re Cohen* 2016 WL 797656 (Bankr. D. Ariz. 2016).
156 *In re Cohen* 2016: par. 4A.
157 *In re Cohen* 2016: par. 4A. The court referred to *In re Shields,* 431 B.R: 450.
158 *In re Cohen* 2016: par. 4B. The court referred to *Massachusetts v Pappalardo (In re Steenstra),* 307 B.R: 740.
159 *In re Cohen* 2016: par. 4B.
160 *In re Cohen* 2016: par. 4C.

the trustee before using them. This approach would benefit *mala fide* debtors while doing nothing to assist those who made genuine attempts to repay creditors.[161]

4.3.5 Duties of Chapter 11 trustee

The duties of a Chapter 11 trustee are quite the same as that of Chapter 13, except that a trustee in Chapter 13 must be appointed in every case. Whereas in Chapter 11, a trustee is only appointed when certain requirements are satisfied. I am of the view that this approach coincides with the idea behind the debtor-in-possession principle. Under this principle, it is assumed that the management of the business knows the affairs of the business well, and it is not necessary to appoint a trustee to oversee the reorganisation of the business. Nonetheless, in certain circumstances, it may be necessary to appoint a trustee. The following discussion explains the grounds for the appointment of the Chapter 11 trustee.

A party in interest may apply to the court for the appointment of a trustee soon after the debtor commences the Chapter 11 case but before the court confirms the reorganisation plan.[162] The applicant must prove one of three grounds: cause of fraud, dishonesty, incompetence or mismanagement; the best interest of creditors or stockholders; and conversion or dismissal of the whole case.

The first ground for the appointment of a trustee is cause of fraud, dishonesty, incompetence or mismanagement. In terms of section 1104(a)(1) of the *Bankruptcy Code*, the court shall appoint a trustee

> for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.[163]

Congress used the term *including* in the opening phrase of this section, suggesting that the list is not exhaustive. On a similar note, the phrase “or similar cause” may be interpreted as drawing the court’s attention to any conduct similar to fraud, incompetence or gross mismanagement. The Code is clear on two points: it identifies the persons or entity that is the debtor’s management and the type of conduct to be investigated: fraud, incompetence, or mismanagement. Thus, the petitioner should

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161 *In re Cohen* 2016: par. 4C.

162 *Bankruptcy Code* 1978:sec. 1104(a).

163 *Bankrutptcy Code* 1978:sec. 1104(a)(1).

demonstrate that there is good cause for the appointment of a trustee to investigate the current management of the insolvent partnership.

The second ground requires the petitioner to show that the appointment of the trustee is "in the interests of creditors, any equity security holders, and other interests of the estate".[164] *In Re Ionosphere Clubs, Inc.*,[165] the Bankruptcy Court held that if the debtor's business affects the general public, then consideration of the public interest becomes a driving factor when deciding whether to appoint a trustee. In weighing the interest of all affected parties, the courts evaluated the trustworthiness of the debtors, their previous record, the prospect of rehabilitation, and their reputation in the community.

The *Bankruptcy Act* 2005 introduced the third ground for the appointment of a trustee. In terms of section 1104, the court may order the appointment of a Chapter 11 trustee where there are sufficient reasons to convert or dismiss the cases under section 1112.[166] Section 1112 of the *Bankruptcy Code* 1978 made it mandatory for the court to consider conversion or dismissal if a cause exists. The ground for such an application may include any failures and prejudicial actions of the debtor that may hinder achieving the objectives of Chapter 11 reorganisation.[167] If, for example, the debtor fails to file its post-petition taxes,[168] the court is directed to convert or dismiss the case unless the debtor demonstrates that there is a reasonable prospect that a reorganisation plan will be confirmed. In addition, the debtor must explain the failure to pay taxes and undertake to cure the situation within a reasonable time as determined by the court.[169]

The appointment of trustees or BRPs should be made parsimoniously. As exemplified in Chapter 11, parliament should set up different grounds for the appointment of BRPs so that businesses may not be burdened by remunerating practitioners instead of recovering. Critics may argue that the debtor-in-possession approach may lead to the abuse of the process, especially where the management of the business caused the financial distress. If creditors or affected persons believe that an examiner should be

164 *Bankruptcy Code* 1978:sec. 1104(a)(2).
165 *In Re Ionosphere Clubs*, *Inc*. 113 B.R. 164, 168 (Bankr. S.D.N.Y. 1990).
166 *Bankruptcy Code* 1978:sec. 1104(a)(3).
167 *Bankruptcy Code* 1978:sec. 1112(b)(4).
168 *Bankruptcy Code* 1978:sec. 1112(b)(4)(I).
169 *Bankruptcy Code* 1978:sec. 1112(b)(2).

appointed when the management of the business caused the financial distress either by committing crimes or mismanagement. The following section provides a brief synopsis of examiners.

4.3.6 Duties of Chapter 11 examiners

In 1970, Congress established the Securities and Exchange Commission Report (hereafter the Commission) to assess the effectiveness of bankruptcy laws in reorganising failing businesses and revisiting the role of the trustee.[170] The Commission Report revealed that trustees play a pivotal role in reorganising debtors, but there were disadvantages, which were overloading the trustee with the duty to conduct an independent investigation, advise the court and creditors, formulate a reorganisation plan, and manage the business.[171] The Commission observed the following:

> In many cases, it is sufficient to require an independent investigation and formulation of a plan, without the ouster of existing management. The presence of an administrative agency as a watchdog over the reorganisation process will make this approach feasible in more cases.[172] If an independent trustee is not appointed, the administrator or any party in interest may request that the court appoint an independent person to investigate or formulate a plan, even though existing management is not ousted.[173]

The Commission recommended that a creditor or any party in interest should have the right and opportunity to request the appointment of an examiner who should investigate the affairs of the debtor before the confirmation of a reorganisation plan.[174] These recommendations were incorporated into a bill, which was later introduced by

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170 *Bankruptcy Act* of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468 (1970).

171 Securities and Exchange Commission 1970:251-253.

172 The reference to *the administrator* relates to the Commission's proposal that an administrative agency be established to remove the court from many aspects of bankruptcy administration. This proposal ultimately led to the creation of the United States Trustee Program.

173 Securities and Exchange Commission 1970:253.

174 Securities and Exchange Commission 1970:253. See proposed section by House Representative Bill 8200:sec. 101 (proposed section 1104): "(a) At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court may order the appointment of a trustee only if (1) the protection afforded by a trustee is needed; and (2) the costs and expenses of a trustee would not be disproportionately higher than the value of the protection afforded. (b) If the court does not order the appointment of a trustee under this section, then at any time before the confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court may order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, or gross mismanagement of the debtor of or by current or former management of the debtor, if (1) the protection afforded by an examiner is needed; and (2) the costs and expenses of an examiner would not be disproportionately higher than the value of the protection afforded."

the House of Representatives, namely the House Bill 8200 of 1977. Concurring with the Commission Report, the House of Representatives Report stated that

> [a] trustee would not necessarily be needed to investigate misconduct of former management of the debtor, because an examiner appointed under this section might well be able to serve that function adequately without displacing the current management.[175]

For the same reason, an examiner cannot be appointed in cases where the court has already appointed a trustee.[176] From this brief background, in the current *Bankruptcy Code*, an examiner is appointed upon request to

> conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor.[177]

The *Bankruptcy Code* 1978 provided that the court shall order the appointment of an examiner if it is shown that the appointment is in the best interest of creditors or any equity holders or other interests of the debtor.[178] It appears that the wording in section 1104(c) is identical to the second ground for the appointment of a trustee. This drafting technic is intentional and purposeful as it emphasises the protection of the creditor's interest while the debtor is under reorganisation.

The primary duty of the examiner is to investigate the affairs of the debtor and provide a detailed report to the court.[179] Such an investigation should reflect the examiner's independence, impartiality and honesty. Scholars such as White and Theus argued that a court would abuse its discretion if it were to order the appointment of an examiner but then enter an order restricting the examiner from performing a meaningful investigation of the debtor and its affairs.[180] If the examiner establishes that the current management has acted wrongfully, it should be reflected in its reports and may serve as a basis for a motion to appoint a trustee under section 1104(a)(1).[181]

South Africa should consider appointing examiners to investigate the affairs of companies that have filed for business rescue before the court issues an order

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175 House of Representatives 1977:8200.
176 The appointment of examiners is governed in terms of *Bankruptcy Code* 1978:sec. 1104(c).
177 *Bankruptcy Code* 1978:sec. 1104(c).
178 *Bankruptcy Code* 1978:sec. 1104(c)(1).
179 *Bankruptcy Code* 1978:sec. 1104(c); see also Bussel 2016: 59-105.
180 White & Theus 2006:309.
181 *Bankruptcy Code* 1978:sec. 1104(a)(1).

commencing business rescue. This view is based on a reflection of the duties and responsibilities of the BRP. The BRP's responsibilities are too many and can therefore not be fulfilled within a reasonable time. Hence, parliament should consider appointing examiners as independent investigators. The courts should make the appointment of examiners in such a situation upon request by any affected person.

The judicial institution is another important structure that supports business reorganisation in the United States. The section that follows explores the role of the Bankruptcy Court during the reorganisation of sole proprietorships and partnerships.

4.3.7 Bankruptcy Court

The venue for lodging a business reorganisation petition is the bankruptcy court.[182] A brief history of bankruptcy courts shows that they are created under Article 1 of the United States Constitution, and their jurisdictions are defined in terms of the *Bankruptcy Act* of 1898.[183] During this era, federal district courts served as bankruptcy courts.[184] Bankruptcy references were appointed for a six-year term by federal district judges. Their primary function was to supervise and administer the disposition of the debtor's property in bankruptcy cases.[185] These matters were usually *in rem* proceedings; in essence, the debtor or the defendant had to consent to jurisdictions. The *Bankruptcy Act* 1898 was later replaced by the *Bankruptcy Code* 1978, which

182 *Federal Rules of Bankruptcy Procedure:* Rule 1001. The main objective of bankruptcy courts is to "[t]o secure the just, speedy, and inexpensive determination of all bankruptcy cases and proceedings." Today's bankruptcy court is progressive and innovative. It is an enthralling forum where competing and countervailing interests of multiple parties are considered and balanced by bankruptcy judges on a daily basis. Some say that the bankruptcy court has become the *de facto* commercial court of the United States.

183 *Northern Pipeline Const. Co. v Marathon Pipe Line Co*., 458 U.S. 50, 102 S. Ct. 2858, 73 L. Ed. 2d 598, 6 Collier Bankr. Cas. 2d (MB) 785, Bankr. L. Rep. (CCH) 68698 (1982). 118. The Supreme Court held that "the very fact of extreme specialization may be enough, and certainly has been enough in the past, to justify the creation of a legislative court. Congress may legitimately consider the effect on the federal judiciary of the addition of several hundred specialized judges: We are, on the whole, a body of generalists."

184 Title 28. Judiciary and Judicial Procedure 2005:sec. 1334 grants the district courts of the United States original and exclusive jurisdiction of all "cases" under TITLE 11 (Bankruptcy Code 2005 including Chapter 11, 12 and 13). A "case" is the umbrella term for the bankruptcy case as a whole. "Proceedings" encompass controversies, adversary proceedings, contested matters, suits, actions or disputes that occur within the case.

185 Williams 2021:3.2, "Prior to the passage of the Bankruptcy Code, bankruptcy cases and their proceedings generally were conducted before a referee (whose title was subsequently changed to judge in 1973), except in those circumstances in which a district court chose to withdraw the case from a referees. A decision entered by a referee was appealable to the district court. Bankruptcy courts were vested with summary jurisdiction — that is, jurisdiction over controversies involving property in the actual (or constructive) possession of the court; the bankruptcy court had no jurisdiction overplenary matters, such as disputes over property possessed by a third person, unless the parties consented to bankruptcy court jurisdiction."

expanded the jurisdiction of the bankruptcy courts to include civil matters emanating from TITLE 11.

The business rescue procedures provided in the *Bankruptcy Code* 1978 heavily rely on the courts.[186] The courts oversee the whole process. Scholars have expressed concerns against the involvement of the courts in the reorganisation process.[187] They argued that the reorganisation of a company or partnership business is administrative in nature.[188] Therefore, the court should only act as an agent. Although this argument can be substantiated, many find the transparency and the independence of the courts to guarantee fairness and certainty of the reorganisation procedure.[189] The following discussion explains the role of the bankruptcy court in the United States.

4.3.7.1 Courts provide efficient and effective structural intervention

The bankruptcy courts intervene in business reorganisation procedures to provide an efficient, coordinated debt-recovery structure. The business reorganisation procedure is premised on the view that a debtor has defaulted in paying one or all of its creditors.[190] Creditors such as the bank, landlord, employees and the tax collector would automatically want to enforce their rights against the debtor. Without the intervention of the *Bankruptcy Code* 1978 rescue procedures, debts would be collected on an individual basis in a state court.[191] Many creditors would flog the courts, and to maintain order, the courts will apply the "race of diligence" model.[192] This means

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186 Lipson 2015:673-738; Stanley & Girth 1971:196.

187 Lipson 2015:673-738; Stanley & Girth 1971:196; Resnick *et al* 2022:46 states that "[t]he U.S.'s restructuring regime is robust for a variety of reasons, but central among them is that it provides a debtor with a central forum to reorganize its worldwide operations. Bankruptcy courts--with their statutory worldwide jurisdiction over a debtor's property--provide that central forum. Notwithstanding the foregoing, the decision in Alto Maipo casts doubt on whether a debtor, relying on the court's worldwide jurisdiction, will be able to take advantage of the full slate of protections afforded by the Bankruptcy Code, particularly the ability to assume a contract that is property of the bankruptcy estate."

188 Lipson 2008:644; Sandler & Schoenbrod 2003:10-12; Yoo 1996:1121.

189 Noonan *et al* 2019:547.

190 *In re RS Legacy Corp*., 62 Bankr. Ct. Dec. 94 (Bankr. D. Del. 2016): "The court defining the term 'substantial contribution' held that activities that primarily further the movant's self-interest do not suffice. Substantial contribution must be calculated to benefit the creditors whose rights have been stayed by the debtor petition for reorganisation in chapter 11. Indeed, if the Movant had accomplished his objective and obtained priority treatment for all the Gift Card Claim Holders, it would have reallocated distributions under the Plan to the detriment of the general unsecured creditors. The Movant's intended end result therefore would diminish the funds available to a certain group of stakeholders while not enhancing overall recoveries to the creditor body."

191 Broude 1993:379; see also Lucey 2001:12. Judicially supervised corporate restructuring is not limited to bankruptcy courts. Several states have receivership and analogous statutes that permit the restructuring of some organisations within that state.

192 Glover 2007: 1253 comments that "Instead of focusing on the rehabilitation of debtors, allowing secured creditors to file proofs of claim at any time seems to take a more "creditor centered approach" to timely filing.

that the first creditor to obtain a judgement against the debtor will prioritise the debtor's secured assets. Individual debt recovery is a race, and the weak end up not recovering anything.[193] Considering that UBEs have multiple creditors, individual debt collection is highly ineffective and, to a more significant extent, arbitrary.

The inefficiencies of individual debt collection stem from the failure to coordinate information asymmetries. Since corporate debtors have multiple creditors, these creditors may be in different jurisdictions. Coordinating creditors in different jurisdictions is difficult since state laws differ from one jurisdiction to another. Moreover, creditors are unlikely to know the position of other creditors. Thus, individual debt collection does not provide an incentive to encourage creditors to share the state of their relationship with the debtor.[194] Even if this were possible, it would be difficult if the debtor's assets would meet all its obligations. Noonan *et al* stated the following:

> Creditors could form groups and pursue their claims collectively. But in cases with widely dispersed creditors, such as trade creditors, or creditors whose claims may be contingent and unliquidated, such as tort creditors, coordination is likely to be difficult, if not impossible. Given the temporal orientation of state collection law, creditors are likely to view themselves as competitors for the debtor's limited assets, not allies.[195]

In many cases, it is unlikely that creditors could avoid the inefficiencies of individual collection actions by organising and renegotiating their relationships without direct or indirect judicial assistance.[196] As mentioned above, most UBEs have obligations to general trade creditors, unsecured creditors, tax agents, and even torts claimants may seek debt recovery.[197] It is often difficult for heterogeneous claimants to effectively communicate and coordinate when the debtor is in financial distress.[198] Therefore, the court's role is to provide a platform upon which all creditors can coordinate the restructuring of the debtor to recover their debts.

Proponents against the involvement of the courts suggest that creditors may agree to coordinate cash out to all creditors through a charter or other contractual mechanisms

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Courts that allow secured creditors to file claims at any time are not focused on the rehabilitation of debtors but are instead focused on a "competing goal" of bankruptcy, namely "efficient debt collection."

193 Afilalo 1992:626.

194 House Committee Report 1978:177-178. For comments on creditors committee, see also Bussel 1996:1547-1553.

195 Noonan *et al* 2019:554; see also Afilalo 1992:628.

196 Noonan *et al* 2019:554.

197 *In re General Growth Props. Inc.,* 409 B.R. 43 (Bankr. S.D.N.Y. 2009).

198 Noonan *et al* 2019:554.

when the debtor defaults. Adler recommended that when the debtor defaults, the debt should be treated as "chameleon equity".[199] According to Adler, chameleon equity is an investment instrument that replaces a traditional debt.[200] Such instruments would allow a company to retain the benefits of debt's fixed obligations, while also allowing for the automatic conversion to debt in the event of an uncured default.[201] The idea behind chameleon equity is taken from the term *chameleon option*. It is possible for a chameleon option's structure to be altered if certain predetermined conditions of the contract are met, such as a specified increase or decrease in the price of the underlying asset. Lipson begged to differ; he argued that although the model proposed by Adler is elegant and practical, it is not appealing to institutional contractualism.[202] Market coordination has also found support among scholars who believe that the courts are not necessary to facilitate debt restructuring.[203] Market coordination refers to renegotiations between major creditors when the debtor defaults. However, market coordination may be precluded by the number and diversity of creditor interests.[204]

The courts address the lack of coordination by imposing a moratorium against all legal procedures. This gives the debtor a breathing space to restructure its business while creditors consolidate their claims against the debtor.

4.3.7.2 Courts as custodians of all stakeholders' interests

During business reorganisation, the debtor will have the same creditors as before the commencement of reorganisation. In most cases, the debtor will have more creditors during reorganisation. These may include new financiers of the business and the reorganisation attempt. Thus, the problem of coordination among creditors does not disappear when the debtor is under reorganisation. The *Bankruptcy Code* 1978 allows the formation of creditor committees to manage and promote coordination between

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199 Adler 1993:332. To be sure, there have been interesting proposals to promote *ex ante* coordination, for example through the charter or other contractual mechanisms that might effectively cash out all creditors upon general default.

200 Adler 1993:324 explained that a *chameleon equity* holder "would possess the same right as a creditor to set payments from the firm, but it would not be permitted to collect individually on an obligation in default".

201 Adler 1993:324.

202 Lipson 2016:261-266 proposed that debt be treated as "chameleon equity" on default. While these models "may have been elegant, their particular proposals seem not to have appealed to the institution contractualists".

203 Roe 1987:232.

204 *Marblegate Asset Mgmt. v Educ. Mgmt. Corp*., 846 F.3d 1 (2d Cir. 2017).

secured and unsecured creditors.[205] In some instances, creditors can form unofficial or *ad hoc* committees. [206]

Official committees are usually composed of unsecured claims. Practises dictates that the creditor of large unsecured claims should serve as committee members.[207] Despite this clear mandate, problems often arise in official committees, mainly if the creditors' claims arise differently. For instance, a contract-based creditor is concerned with the ongoing business, whereas tort-based creditors concentrate on once-off payments. Bondholders prefer strategies that will guarantee an increase in their collateral which may conflict with shareholders who are likely to push for high-risk strategies that may plunge the debtor into bankruptcy. In all this confusion, employees may not even be represented.[208] Harner and Marincic argued that although the committee structure holds the promise of representation and cooperation, creditors' committees and, to some extent, always have been vulnerable to manipulation, conflict and self-interest.[209] Committee capture poisons the foundations of business reorganisation that is taking a calculated risk. It is unreasonable for creditors to consent to a business reorganisation plan that only represents the interests of one creditor or most influential creditor(s).

The courts, in such instances, emerge as the only custodian of a stakeholder's rights. This means that the court's role during business reorganisation is to balance the interests of all stakeholders. I believe that bankruptcy courts have the capacity and expertise to consider the interest of all creditors, especially where a creditor has a grievance against the committee or its decision. Although committees may have knowledge and expertise in the debtor's business, the court is the appropriate institution for any aggrieved party, whether the debtor or any member of the official or

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205 *Bankruptcy Code* 1978:sec. 1102(a).

206 Harner & Marincic 2011:751; Klee & Shaffer 1993:998.

207 *Bankruptcy Code* 1978:sec. 1102(b).

208 Noonan ***et al*** 2019:566. Despite these imperfections, representative participation through official and unofficial committees is considered the most effective available means of policing and negotiating with management in order to restructure the debtor. These representatives likely have a better understanding of the debtor's business than would the court, so their participation is critical to restructuring the company.

209 Harner & Marincic 2011:763-764. Brussel 1996:1553, in his description of the early days of creditors' committees noted that "[a] corporation's creditors typically are wide dispersed with various (often competing) economic interest and agendas. Early committees frequently were self-selected limited to a particular tranche of debt and not necessarily formed to represent the interests of the corporation' general creditors body."

unofficial party. The courts remain the only safeguard for the interests of all stakeholders.

4.3.7.3 Authority to order involuntary reorganisations

The courts are the only institutions with the authority to order involuntary debt restructuring or compulsory reorganisation. In this regard, the court's role is to assess whether a debtor must be placed under compulsory reorganisation. If creditors believe that the debtor is in financial distress but resists negotiations, creditors may commence compulsory reorganisation.[210]

In a compulsory reorganisation petition, the court is faced with two conflicting interests. On the one hand, the creditor's application is mainly prompted by fear of the race of diligence and prevents others from collecting the debtor's property.[211] The debtor's management may also plunder or continue to mismanage the debtor's business. On the other hand, if the creditors are wrong, the reorganisation may disrupt the business, and destabilise relations with suppliers and other stakeholders.[212] In essence, if creditors commence a compulsory reorganisation on a solvent debtor, it may result in the total failure of the debtor's business. The court's mandate is to decide whether business reorganisation is viable. If the debtor proves that its business is sound and solvent, the courts may penalise the creditors who filed the compulsory reorganisation petition.[213] Scholars who doubt the valuable function of the courts seem to ignore that courts are not agents of the reorganisation procedure but the faithful custodian of the interests of both the debtor and the creditor. The independence of the courts is a

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210 *Bankruptcy Code* 1978:sec. 303(b)(1). "To establish a prima facie case, the creditors must demonstrate that the debtor is failing to meet its obligations and a reorganisation procedure may save its business. Unfortunately, a debtor with multiple creditors (at least eleven creditors) cannot be placed under compulsory reorganisation unless at least three of its creditors holding about $15,000 unsecured claims support and join the claim. The creditors must be prepared to prove that the debtor has already defaulted or that the debtor will not be able to pay its debtors when they become due."

211 House Committee Report 1978:177-178: "By permitting the trustee to avoid prebankruptcy transfers that occur within a short period before bankruptcy, creditors are discouraged from racing to the courthouse to dismember the debtor during his slide into bankruptcy. The protection thus afforded the debtor often enables him to work his way out of a difficult financial situation through cooperation with all of his creditors. Second, and more important, the preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. Any creditor that received a greater payment than others of his class is required to disgorge so that all may share equally. The operation of the preference section to deter 'the race of diligence' of creditors to dismember the debtor before bankruptcy furthers the second goal of the preference section—that of equality of distribution." See also Beavers 1992:999.

212 Block-Leib 1991:803-806.

213 *Bankruptcy Code* 1978:sec. 303(i). *In re John Richard Homes Bldg. Co*., 291 B.R. 727 (Bankr. E.D. Mich. 2003). The Court held that the creditor had commenced involuntary reorganisation based on bad faith and awarding compensatory and punitive damages to debtor.

guarantee of fairness in such proceedings. Without the court's approval any decision to place the debtor under compulsory reorganisation is arbitrary.

4.3.7.4 Constitutional jurisdiction to confirm a business reorganisation plan

After the debtor has solicited votes from its creditors, it should approach the court to confirm its plan.[214] The court may not confirm the reorganisation plan if it discharges the liabilities of non-debtors.[215] In *In re Lowenschuss*,[216] the Bankruptcy Court, 9th Circuit, held that section 524 precludes bankruptcy courts from discharging the liabilities of non-debtors.

The same issue was addressed in the case of *In re Millennium Lab Holdings II, LLC*,[217] The United States Bankruptcy Court for the district of Delaware had to determine whether the bankruptcy court had the constitutional authority to approve nonconsensual third-party releases under a Chapter 11 plan. The court held that it "had related jurisdiction" to confirm the non-consensual third-party releases.[218] On appeal, the District Court of Appeal upheld the district court's decision, holding that it had incidental or related jurisdiction over matters arising from bankruptcy cases.[219] In its judgement, the court cited *Pacor, Inc. v Higgins*[220] in that case; the court held the following:

> For a civil proceeding to be related to bankruptcy such that jurisdiction exists to entertain the matter in federal courts, it need not necessarily be against [a] debtor or against [the] debtor's property; an action is related to bankruptcy if the outcome could alter debtor's rights, liabilities, options, or freedom of action, either positively or

214 *Backruptcy Code* 1978:sec. 1325.

215 *Bankruptcy Code* 1978:sec. 524(e).

216 *In re Lowenschuss*, 67 F. 3d 1394, 1401, 34 Collier Bankr. Cas. 2d (MB) 544, Bankr. L. Rep. (CCH) P 76673, 33 Fed. R. Serv. 3d 249 (9th Cir. 1995).

217 *In re Millennium Lab Holdings* II, LLC, 575 B.R. 252, R.I.C.O. Bus. Disp. Guide (CCH) P 12944 (Bankr. D. Del. 2017). "The facts of the case are that the debtors filed a prepackaged plan of reorganization for approval on an expedited schedule. The proposed plan would be funded in large part by a $325 million contribution from certain of the debtor's equity holders under a global settlement of claims contained in the plan. In exchange for the settlement and contribution, the nondebtor entities received releases under the plan from the debtor and its creditors of common law fraud and RICO claims related to a prepetition leveraged recapitalization and financing transaction. group of prepetition lenders (known collectively as "Voya") objected to the release and accompanying bar order and injunction on a variety of grounds, including that the bankruptcy court lacked subject-matter jurisdiction over the released claims and that approval of the releases did not meet the standards for such approval under controlling Third Circuit precedent, as set forth in *Gillman v Continental Airlines* 203 F.3d 203, 35 Bankr. Ct. Dec. (CRR) 176 (3d Cir. 2000)."

218 In re Millennium Lab Holdings 2017:257.

219 *In re Millennium Lab Holdings* 2017:338. The court cited *Pacor, Inc. v Higgins*, 743 F. 2d 984, 994, 12 Bankr. Ct. Dec. (CRR) 285, Bankr. L. Rep. (CCH) P 70002 (3d Cir. 1984.

220 *Pacor, Inc. v Higgins*, 743 F. 2d 984, 994, 12 Bankr. Ct. Dec. (CRR) 285, Bankr. L. Rep. (CCH) P 70002 (3d Cir. 1984.

> negatively, and which in any way impacts upon handling and administration of bankrupt estate.[221]

It should be understood that non-debtor liabilities relate to the liabilities of guarantors and insurers who are not the primary debtors. The court's exercise of its jurisdiction is meant to determine the debtor's rights and freedoms under bankruptcy. Without this "related jurisdiction", the debtors would have to apply to the state courts. This may prove to be expensive for debtors who are already in financial distress.

4.3.8 Summary

The bankruptcy system of the United States offers several lessons for South Africa. The *Bankruptcy Code* 1978 provides that when a debtor applies for reorganisation in Chapter 11, 12 or 13, they remain in charge of their business. The *debtor in possession* strategy may work well for UBEs since the business heavily depends on their expertise. Furthermore, Chapter 13 is clear on the duties of the debtor. The debtor is primarily required to continue managing the business and making a profit. This responsibility is reinforced by the debtor's duty to regularly report to the trustee. It keeps the trustee well informed about the debtor's financial affairs. The debtor has the authority to negotiate post-commencement finance. Rather than limiting the debtor's authority, the *Bankruptcy Code* 1978 allows the debtor to incur further operational expenses, which should also be calculated to salvage the business. Generally, the debtor must conduct the business in the best interest of creditors and the estate.

If the debtor is a partnership, the court also directs that the management of the partnership should remain in possession. The approach protects the business's goodwill and motivates the partners to contribute to the recovery of the business. In fact, the *Bankruptcy Code* 1978 requires all partners to contribute to the reorganisation plan. The trustee is authorised to commence legal proceedings against partners if they fail to contribute. Such an approach is an incentive to creditors who bear the risk of loss if the reorganisation fails. Partners are required to exercise their common law fiduciary duties when conducting the partnership business during reorganisation.

The trustee is appointed to oversee the implementation of the business reorganisation. The *Bankruptcy Code* 1978 requires that in every case, a trustee must be appointed

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221 *Pacor Inc v Higgins* 1984:994-5. An interpretation of this granting jurisdiction contradicts the findings. See also *In re McConaghy*, 15 B.R. 480, 481 (Bankr. E.D. Va. 1981) The court held that the Bankruptcy Court lacks jurisdiction to decide disputes between third parties in which the estate of the debtor has no interest.

if the debtor is a sole proprietorship. The approach is different if the debtor is a partnership or a company. South Africa can learn a valuable lesson from the conditions for the appointment of a trustee. One must not forget that a trustee is the BRP of Chapter 11. Thus, a Chapter 11 trustee is only appointed where there is reason to believe that the debtor is in financial distress because the management committed fraud, dishonesty, or was merely incompetent. Furthermore, the trustee is appointed if it is in the best interest of the creditors. Unlike in South Africa, the United States approach to the trustee's appointment minimises legal costs, and the practitioner is appointed only when necessary. Another valuable lesson from the bankruptcy court is the establishment of specialised courts. The *Bankruptcy Code* 1978 makes provision for the creation of bankruptcy courts with special limited jurisdiction. The purpose of the court is to provide an organised structure for the collection of debts and the recovery of the debtor's business. After the failure of workouts and creditor committees, the bankruptcy court emerged as the solution. The proposed section provides reasons why South Africa should consider specialised courts.

4.4 UNITED KINGDOM

The administration of business rescue and bankruptcy procedures in England and Wales are overseen by the State's two main organs, namely the Judiciary and the Department of Business, Innovation and Skills,[222] with the Insolvency Service as one of its sub departments. [223] The main function of the Insolvency Service is to control and supervise office receivers,[224] IPs and turnaround professions.[225] This section

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222 Morse 2021:15.03; see also Calitz 2010:105; Finch 2009:178-190; Fletcher 2009:17-20; Xie 2012:85-103. The current statutory framework concerning the Official Receiver offices is contained in Pt XIV of the *Insolvency Act* 1986, together with Pt XIV of the *Insolvency (England and Wales) Rules* 2016 (SI 2016/1024).

223 The Insolvency Service consists of two divisions: the office of the official receivers and the service headquarters. The concept of an executive agency is part of the new public management initiatives that were introduced in many Organisation for Economic Co-operation and Development (OECD) countries in the 1990s, according to which government should be run like a business, with a focus on outputs and quantification and a more competitive basis for providing public service.

224 *Insolvency Act* 1986:sec. 400(2). The official receiver is a civil servant working on behalf of the insolvency service and is also an officer of the court. They respond to notifications from the courts of individual voluntary arrangements or partnership administration, and administer the initial stages, although they may also be involved throughout the process in some cases. The official receiver is accountable to both the courts and to the Secretary of State for Business, Innovation and Skills, and their role varies depending on the circumstances of each insolvent debtor facing liquidation.

225 Wheeler 1994:85-104; see also Finch 1998:334; Insolvency Regulation Working Party (IRWP) 1998. The IRWP had, as members, representatives of each of the professional bodies that authorise insolvency practitioners, as well as the Department of Trade and Industry (DTI) which became the Department for Business, Enterprise and Regulatory Reform's (BERR's) Insolvency Service, with the Association of Business Recovery Professionals (R3) (formerly the Society of Practitioners of Insolvency) in attendance.

explains the role of the official receiver during the rescue of a sole proprietorship. The discussion is followed by examining the administrator's duties in a partnership administration and the court's involvement in all proceedings.

4.4.1 Official Receiver office(s)

The most important organ of the institutional framework for insolvency and business rescue is the official receiver offices. It administers all insolvencies throughout England and Wales.[226] The official receiver offices were created by the *Bankruptcy Act* 1883 to monitor and supervise bankruptcy cases. The main objective of the official receiver was to control bankruptcy proceedings, whether liquidation or rescue and conduct investigations related to insolvency or bankruptcy.[227] The official receiver's role was extended to compulsory liquidations by the CA 1890 and is today largely set out in IA 1986. This office is operated by official receivers who are appointed by the Secretary of State.[228] They are recognised as officers of the court and receive their instructions from the inspector general of the Insolvency Service.[229] It is essential to note that where the official receiver must perform the statutory duty, practice shows that the official receiver at the relevant court will carry out the function.[230] The discourse below explains the role of the official receiver during the implementation of alternatives to bankruptcy applicable to sole proprietorships.

4.4.1.1 Duty to adjudicate applications for debt relief orders

The most innovative aspect of the institutional framework in the UK is that the court is not the only institution dealing with DRO applications. In terms of section 251 of the

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226 Fletcher 2009:31; see also Murphy 1999:111-116.

227 Morse 2021:15.03. The retention within the legislative reforms of 1985–86 of an active involvement for the official receiver in all cases of compulsory winding up [and IVAs), combined with the reaffirmation of the role of the Insolvency Service in detecting and prosecuting cases of illegal conduct related to the management of companies, represented an important victory for the recommendations of the Insolvency Law Review Committee over previously announced governmental aspirations to reduce the number of personnel engaged in the work of the Insolvency Service, and to diminish as far as possible their involvement with insolvency proceedings.

228 *Insolvency Act* 1986:sec. 399(1). "For the purposes of this Act the official receiver, in relation to any bankruptcy [winding up, individual voluntary arrangement, debt relief order or application for such an order], is any person who by virtue of the following provisions of this section or section 401 is authorised to act as the official receiver in relation to that bankruptcy [winding up individual voluntary arrangement, debt relief order or application for such an order]."

229 *Insolvency Act* 1986:sec. 400(2). "In the exercise of the functions of his office a person holding the office of official receiver shall act under the general directions of the Secretary of State and shall also be an officer of the court in relation to which he exercises those functions."

230 Calitz 2010:107; Fletcher 2009:32.

IA 1986, a debtor can apply to the official receiver for a DRO. Once the application is made, the official receiver must decide whether to accept, deny, or postpone the matter for further investigation of the debtor's circumstances.[231] A question arise: *Does this mean that the official receiver performs the function of a judge?*

The official receiver is not a court or tribunal or forum, but parliament has conferred juridical powers similar to the powers exercised by traditional judges.[232] When the official receiver considers and determines an application for a DRO, it needs to assess whether certain conditions are met. In addition, section 251(4) provides the official receiver with discretionary powers on whether to reject or approve the debtor's application. If there are queries, the official receiver has the authority to stipulate the time frame upon which the debtor should address them. Generally, the process involves a mixture of mandatory and discretionary provisions, demonstrating a judicial function. Although the process is not adversarial, which may allow a creditor to object to the debtor's application, the official receiver is bound to apply several statutory evidential presumptions set out in section 251D.[233] It appears that this function does not fall short of the same function discharged by judges in a court of law.

The official receiver has the power to review his own decision, either revoking or amending the order.[234] In this regard, the IA 1986 provides a series of different grounds

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231 *Insolvency Act* 1986:sec. 251C. In terms of section 251C, the "official receiver may stay consideration of the application" until the debtor provides answers to objections that may have been raised concerning his application. If the official receiver is of the view that the debtor does not meet the requirements for a DRO, he must refuse the debtor's application. If the official receiver decides to refuse the application, he must provide the debtor with reasons for his decisions. However, where the debtor meets the criteria, the official receiver must make the order favouring the debtor.

232 *R.* (*on the application of Howard) v Official Receiver* [2013] EWHC 1839 (*Howard v Official Receiver* 2013) par. 104. In summary, the court held that in determining an application for a debt relief order under the *Insolvency Act* 1986 sec. 251C, or deciding whether to revoke such an order under section 251L, the Official Receiver was exercising a judicial function within the meaning of the *Equality Act* 2010 Sch. 18 para. 3(1)(a) and, accordingly, in making such decisions was not subject to the public sector equality duty under section 149 of that Act.

233 *Insolvency Act* 1986:sec. 251D. The section provides that "(1) The following presumptions are to apply to the determination of an application for a debt relief order. (2) The official receiver must presume that the debtor is an individual who is unable to pay his debts at the determination date if– (a) that appears to the official receiver to be the case at the application date from the information supplied in the application and he has no reason to believe that the information supplied is incomplete or inaccurate; and (b) he has no reason to believe that, by virtue of a change in the debtor's financial circumstances since the application date, the debtor may be able to pay his debts. (3) The official receiver must presume that a specified debt (of the amount specified in the application and owed to the creditor so specified) is a qualifying debt at the application date if– (a) that appears to him to be the case from the information supplied in the application; and (b) he has no reason to believe that the information supplied is incomplete or inaccurate."

234 *Insolvency Act* 1986:sec. 251L. This section sets out the circumstances in which the official receiver may revoke the order and gives him a power to amend the order during the moratorium period to correct errors and omissions. Revocation may take place when information provided by the debtor to the official receiver turns out to be incomplete or misleading, or where the debtor fails to comply with his duties to provide

upon which the order may be amended or revoked. The official receiver may review its decision if the DRO was made erroneously,[235] for instance, whether the debtor failed to comply with section 251J.[236] Furthermore, section 251(3) provides that the official receiver may revoke the order when convinced that the debts identified by the debtor were qualifying debts. Moreover, when the debtor's monthly surplus income and property requirement is not met after the DRO was made.[237] However, the official receiver cannot add any debts that were not indicated in the DRO application.

In *Howard v Official Receiver,*[238] the court was called to decide whether an official receiver is subject to the public sector equity duty under section 149 of the *Equality Act* 2010. The public equity duty was created to harmonise the previous race, disability and gender equality duties and extend protection to the new protected characteristics listed in the EA 2010.[239] Howard argued that the official receiver failed to comply with section 149 of the EA 2010 by revoking the DRO in her favour.[240] The official receiver accepted that Howard was "disabled" as defined in the Act but maintained that she was not required to consider section 149 since she was exercising a judicial function as provided in Schedule 18 to the Act.[241]

The court held that the question to be determined was whether parliament intended that the official receiver should consider the public equity duty.[242] However, to impose the public sector equity duty on judges in deciding criminal and civil matters is unethical.[243] The court further held that the judicial and administrative processes are two different processes.[244] The former is concerned with determining rights and liabilities, whereas the latter focuses on allocating resources. Thus, the application of

information or attend on the official receiver. The order may also be revoked if the official receiver ought not have made the order because he ought not have been satisfied the criteria were met and also if the debtor's income and property levels change (for example following a windfall) after the order has been made and the debtor would no longer meet the criteria for obtaining an order.

235 *Insolvency Act* 1986:sec. 251L(8).

236 *Insolvency Act* 1986:sec. 251l(2).

237 *Insolvency Act* 1986:sec. 251L(4); Schedule 4ZA par. 7 and 8.

238 *Howard v Official Receiver* 2013: para 152-154.

239 *Equality Act* 2010:149. Preamble of the Act: "Removing or minimising disadvantages suffered by people due to their protected characteristics. Taking steps to meet the needs of people from protected groups where these are different from the needs of other people. Encouraging people from protected groups to participate in public life or in other activities where their participation is disproportionately low."

240 *Equity Act* 2010:sec. 149.

241 *Equity Act* 2010: ch.18 para. 3(1)(a).

242 *Howard v Official Receiver* 2013: par. 153.

243 *Howard v Official Receiver* 2013: par. 155.

244 *Howard v Official Receiver* 2013: par. 163-166.

the public sector equity duty in the context of judicial decision-making would be prejudicial to the parties involved.[245] When the official receiver makes a DRO, any other debt restructuring process in place ceases, and a moratorium commences. Thus, all creditors cannot enforce their rights against the debtor.[246] Obtaining a DRO is judicial in nature, and the presiding officer has the power to review its own decision.[247]

In the case of*In Re Arthur Williams and Co*,[248] an official receiver applied to the court for an order of adjudication against a man alleged partner of a firm. Having found that the man was not a partner of the firm, the registrar dismissed the application for adjudication and ordered the official receiver to pay the costs. The Court of Appeal held that the registrar had jurisdiction to make that order.[249] However, an official receiver enjoys the same immunity as judicial members.[250] This case provides a significant perspective on the profession of official receivers. Although they are not appointed as judges or magistrates, they carry out quasi-judicial functions.

4.4.1.2 Duty to investigate the affairs of the debtor

The power of the official receiver to investigate the debtor is provided in section 251K. According to this section, the official receiver may decide to investigate the debtor's affairs to consider the authenticity of the creditor's objections.[251] He may investigate any matter that appears relevant in making a DRO or revoking or amending the

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245 *Howard v Official Receiver* 2013: par. 169.

246 *Howard v Official Receiver* 2013: *par.* 174. See also *R. (on the application of Payne) v Secretary of State for Work and Pensions* [2010] EWCA Civ 1431. In its ordinary meaning, the provision in the *Insolvency Act* 1986 s. 251G(2)(a) that during the moratorium after a debt relief order had been made a creditor had no "remedy in respect of the debt" prevented the Secretary of State for Work and Pensions from deducting at source overpayments or repayments of benefit that were specified in the order as qualifying debts.

247 *Howard v Official Receiver* 2013: par. 192.

248 *In Re Arthur Williams and Co* [1913] 2 KB 88.

249 *In Re Arthur Williams and Co* [1913] 2 KB 88.

250 *In Re Arthur Williams and Co* [1913] par. 93 -94. The court clarified that "where an official receiver, or an official liquidator (for this present purpose I will call him the official receiver), is simply performing duties which are obligatory upon him in a judicial, or quasi-judicial, character, he is not to be made to pay costs, because he is acting in the performance of his official duty; but whenever the moment comes when he does that which he is under no obligation to do, although he is empowered to do it if he thinks fit, and has a right to do it, then his protection as a judicial officer, or a person of a semi-judicial character, ceases."

251 *Insolvency Act* 1986:sec. 251K(4). The official receiver may carry out an investigation of any matter that appears to the official receiver to be relevant to the making of any decision mentioned in subsection (5) in relation to a debt relief order or the debtor.

same.[252] In terms of section 251K (7), the official receiver may require any person to give him such information and assistance as he may reasonably require in connection with an investigation.[253] The power to investigate is exercisable during and after the moratorium relating to the order.[254]

The official receiver may also apply to the court for an inquiry into the debtor's affairs.[255] On the application of the official receiver, the court may direct the debtor or any person connected to the debtor to appear in court and provide information on the debtor.[256] In this regard, the court may issue a warrant of arrest, order seizure of articles, property, and any items belonging to the debtor.[257] Parliament does not envisage the frequent use of the courts, and in a few cases, the court will be required to inquire into the debtor's affairs, especially where the debtor fails to cooperate with the official receiver during investigations.[258]

While the official receiver has the power to investigate, judge, and review their own decisions, section 251M of the IA 1986 enables any person who is not satisfied with the actions of the official receiver to make an application to the court. This means that the debtor or his creditors may apply to the court to instruct the official receiver office to investigate an official receiver's actions. The court may give directions or make an

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252 *Insolvency Act* 1986:sec. 251K(5). The decisions to which an investigation may be directed are– (a) whether the order should be revoked or amended under section 251L; (b) whether an application should be made to the court under section 251M; or (c) whether any other steps should be taken in relation to the debtor."

253 *Insolvency Act* 1986:sec. 251K(7). The official receiver may require any person to give him such information and assistance as he may reasonably require in connection with an investigation under this section.

254 *Insolvency Act* 1986:sec. 251K(6). The power to carry out an investigation under this section is exercisable after (as well as during) the moratorium relating to the order.

255 *Insolvency Act* 1986:sec. 251(N).

256 *Insolvency Act* 1986:sec. 251N(1) & (2). "An order under this section may be made by the court on the application of the official receiver. An order under this section is an order summoning any of the following persons to appear before the court– (a) the debtor; (b) the debtor's spouse or former spouse or the debtor's civil partner or former civil partner; (c) any person appearing to the court to be able to give information or assistance concerning the debtor or his dealings, affairs and property."

257 *Insolvency Act* 1986:sec. 251N(5). "The court may cause a warrant to be issued to a constable or prescribed officer of the court– (a) for the arrest of that person, and (b) for the seizure of any records or other documents in that person's possession. See also subsection (6) The court may authorise a person arrested under such a warrant to be kept in custody, and anything seized under such a warrant to be held, in accordance with the rules, until that person is brought before the court under the warrant or until such other time as the court may order."

258 Government's Explanatory Notes to the Act 2019.

order it deems fit.[259] It is a safety net for the general public in case the official receiver abuses its powers.

4.4.1.3 Duty to supervise an individual voluntary arrangement

The official receiver can be nominated for appointment as the supervisor of an IVA.[260] To act as the nominee or supervisor, a person must be a qualified insolvency practitioner.[261] The nominee applies for an interim order that has the effect of staying any actions against them or their property.[262] Thereafter, the nominee must report to the court, stating whether a meeting of creditors should be called to consider the proposal. If a meeting is called and the creditors approve the individual IVA, the interim order can be discharged, and any bankruptcy order may be annulled. The main function of the supervisor is to monitor the implementation of the IVA and report to the court.[263]

4.4.2 Duties of the administrator in partnership administration

A comprehensive list of the duties of the administrator during the administration of an insolvent partnership is provided in Article 6, paragraph 43 of IPO 1994.[264] From the onset, it is important to indicate that paragraph 43 is a modified version of Schedule B1, paragraph 60 of IA 1986, which provides the administrator's responsibilities to oversee the administration of a company. Since case law and legal opinions are very few on partnership administrators, the discussion makes most of its references to company administrators. An administrator is an officer of the court and an agent of the company or partnership.[265] The following section evaluates the role and function of an administrator in the recovery of an insolvent partnership.

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259 *Insolvency Act* 1986:sec. 251M. "(1) Any person may make an application to the court if he is dissatisfied by any act, omission or decision of the official receiver in connection with a debt relief order or an application for such an order."

260 *Insolvency Act* 1986:sec. 389B(1). "The official receiver is authorised to act as nominee or supervisor in relation to a voluntary arrangement approved under Part VIII provided that the debtor is an undischarged bankrupt when the arrangement is proposed."

261 A thorough exposition of the duties and responsibilities of the insolvency practitioner in an individual voluntary arrangement is provided by Duncan & Robinson 2019:132-134.

262 *Insolvency Act* 1986:sec. 252-255.

263 See Chapter 3 for details of the procedure.

264 See also Mokal & Armour 2004:136.

265 See Riley 2018: 86-88.

4.4.2.1 Duty to take over the management of the partnership business

Upon appointment, an administrator takes over the management of the partnership business.[266] Totty *et al.* commented that although the powers outlined in Schedule 1 do not authorise an administrator to remove a partner or appoint a new partner, the administrator may simply determine the functions of each partner.[267] Nonetheless, it is clear that the administrator should manage the partnership's business for the benefit of all interested in the insolvent estate.[268] In *Key2Law (Surrey) LLP v De'Antiquis*,[269] Lord J Rimer held that the administrator's overriding legal obligation is to perform his functions with the objective of rescuing the company concerned.[270] Basically, when the administrator of a partnership accepts an appointment, he automatically becomes an agent of the partnership.[271]

The administrator must collect and have access to the partnership property.[272] In *Smith v Bridgend CBC,*[273] the House of Lords held that an administrator does not acquire an interest in a company but rather exercises the company's right of collection for purposes of the administration. A juxtaposition of the company and the partnership administrator indicates that neither does the administrator become a shareholder or partner of the debtor nor acquires shares or interest over the debtor's property.[274] Hence, the administrator exercises his right to collect as an agent of the debtor.

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266 *Insolvent Partnership Order* 1994: par. 43(13). The administrator has "[t]he power to carry on the business of the partnership".

267 Totty *et al* 2021:11-15.

268 Lightman & Moss 2000: paras 1-10; Lightman *et al* 2007:20-40. *Bristol Airport plc v Powdrill* [1990] BCC 130; [1990] Ch 744; *In re UCT (UK) Ltd* [2001] 1 WLR 436; *Denny v Yeldon* [1995] 3 All ER 62.

269 *Key2Law* (Surrey) LLP v De'Antiquis [2011] 12 WLUK 707.

270 *Key2Law (Surrey) LLP v De'Antiquis* [2011]: par. 32: "The overriding duty of an administrator is to perform his functions 'in the interests of the company's creditors as a whole. In doing so, he must perform them with the objective of achieving the objective in paragraph 3(1)(a) ('rescuing the company as a going concern') unless, however, he thinks that it is not reasonably practicable for him do so *or* that the objective of paragraph 3(1)(b) 'would achieve a better result for the company's creditors as a whole.' Paragraph 3(4) provides for the circumstances in which the administrator may perform his functions with the objective of paragraph 3(1)(c), an objective falling at the lower end of the hierarchy of priority."

271 *Insolvent Partnership Order* 1994: par. 43(8). The administrator has the "[p]ower to do all acts and execute, in the name and on behalf of the partnership or of any member of the partnership in his capacity as such, any deed, receipt or other document."

272 *Insolvent Partnership Order* 1994: par. 43(1). "Power to take possession of, collect and get in the partnership property and, for that purpose, to take such proceedings as may seem to him expedient."

273 Smith (Administrator of Cosseltt (Contractors) Ltd v Bridgend CBC [2002] 1 All E.R. 292

274 Dundas 2002:170-171. Any action brought by an administrator to assert a claim on behalf of the company should be in the name of the company, title to the claim vesting in the company.

In carrying on the partnership business, the IPO, article 6, par. 43, authorises the administrator to designate an agent to perform any business that he cannot perform himself or that is more conveniently performed by an agent.[275] One of these agents can be a partner of the partnership.[276] If the business depends on the partners' expertise, the administrator should appoint the partner to perform such duties. For instance, in a firm of doctors, the administrator may have to appoint doctors to continue as such while he administrates the partnership business. During the administration of the partnership, the administrator may decide to transfer the entirety or a portion of the partnership's business or property to subsidiary enterprises of the partnership.[277]

4.4.2.2 Duty to raise finances for the partnership

The IPO 1994 permits the administrator to raise or borrow money and grant security over the partnership property.[278] One way an administrator may raise funds for the partnership is to sell some of its property.[279] This duty suggests that the selling of such property should be in accordance with a proposed administration plan.[280] It would mean that the administrator may not sell the company's assets before the creditors approve the proposed administration plan. In *Transbus International Ltd,*[281] the court clarified that where the creditors have not yet approved the administrator's proposals, it is unnecessary to seek the court's direction before selling the company's property.[282]

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275 *Insolvent Partnership Order* 1994: par. 43(10). Power to appoint any agent to do any business which he is unable to do himself or which can more conveniently be done by an agent and power to employ and dismiss employees.

276 Kavanagh 1995:92-93. For a thorough discussion of partnership administration, see also Mark 2012:124-126.

277 *Insolvent Partnership Order* 1994: par. 43(15).

278 *Insolvent Partnership Order* 1994: par. 43(3). Power to raise or borrow money and grant security over the partnership property."

279 *Insolvent Partnership Order* 1994: par. 43(2). Power to sell or otherwise dispose of the partnership property by public auction or private auction or private contract or, in Scotland, to sell, feu, hire out or otherwise dispose of the partnership property by public group or private bargain.

280 The requirement under paragraph 68(1) of Schedule B1 to the *Insolvency Act* 1986, as amended, that administrators of a company "shall manage its affairs, business and property in accordance with-(a) any proposals approved under paragraph 53". This means that they need the court's approval if the proposal is not yet approved.

281 *Transbus International Ltd (In Liquidation), Re* [2004] EWHC 932 (Ch); [2004] 1 W.L.R. 2654; [2004] B.C.C. 401.

282 *Transbus International Ltd (In liquidation)* [2004]: par. 14-14. There will be many cases where the administrators are justified in not laying any proposals before a meeting of creditors. This is so where they conclude that the unsecured creditors are either likely to be paid in full, or to receive no payment, or where neither of the first two objectives for the administration can be achieved. See paragraph 52 of the Schedule. If, in such administrations, administrators were prevented from acting without the direction of the court it would mean that they would have to seek the directions of the court before carrying out any function throughout the whole of the administration. The *Enterprise Act* 2002 reflects a conscious policy to reduce the involvement of the court in administrations, where possible.

However, the modified version of the same duty does not require the administrator to sell the property following an approved plan. Paragraph 43 of the IPO reads as follows:

> [The administrator has the p]ower to sell or otherwise dispose of the partnership property by public auction or private auction or private contract or, in Scotland, to sell, feu, hire out or otherwise dispose of the partnership property by public group or private bargain.

It seems that the plain language in par. 43 adequately captures the intention of the parliament in administrating proceedings, that is, to minimise the involvement of the court. Collins J in *Transbus International Ltd* acknowledged that EA 2002 reflects a conscious policy to reduce the court's involvement in administrations.[283]

Since the courts are not closely involved in the sale or disposition of the debtor's business, an important question arises: *What is the administrator's duty when selling a partnership property and is any prize acceptable?* In *Re Charnley Davies Ltd (No. 2)*,[284] the creditors claimed that the administrator breached his duty of care and diligence when he sold the company's assets at a lower price. Millet J held the following:[285]

> "[I]t is not an absolute duty to obtain the best price that circumstances permit but only to take reasonable care to do so, and in my judgment that means the best price that circumstances as he reasonably perceives them to be permit. He is not to be made liable because his perception is wrong, unless it is unreasonable … A complaint that [an administrator] has failed to take reasonable care in the sale of the company's assets is, therefore, a complaint of professional negligence and in my judgment the established principles applicable to cases of professional negligence are … applicable in such a case.

This judgement suggests that when the administrator fails to secure the best price for the property, the claimant must prove professional negligence rather than the breach of duty of care and diligence. Technically, this implies that the claim will not be levied against the partnership but the administrator in his personal capacity. In *Kyrris v Oldham,*[286] the Court of Appeal was called to decide whether an administrator in a partnership under administration owed a duty of diligence and care to the partners. The court held the following:[287]

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283 *Transbus International Ltd (In Liquidation)* [2004]: par. 12-14.

284 *Re Charnley Davies Ltd* (No.2) [1990] B.C.C. 605; [1990] B.C.L.C. 760 Ch D (Companies Ct).

285 *Re Charnley Davies Ltd* (No.2) [1990] B.C.C. 605.

286 *Kyrris v Oldham* [2003] EWCA Civ 1506; [2004] B.C.C. 111; [2003] 11 WLUK 69 (CA (Civ Div).

287 *Kyrris v Oldham* [2003]: par. 146.

> Given the nature and scope of an administrator's powers and duties, I can for my part see no basis for concluding that an administrator owes a duty of care to creditors in circumstances where a director would not owe such a duty to shareholders. In each case the relevant duties are absent special circumstances, owed exclusively to the company.

Regarding South Africa, as a result of the partnership being considered a legal entity throughout the rescue procedure, the practitioner is in a position very similar to that of a business rescue practitioner described in Chapter 6 of the business rescue scheme. I believe that the business judgement rule should protect the administrator appointed to assist a partnership or a sole proprietorship. The business judgement rule is a company law doctrine adopted by courts in the United States to shield company directors from legal liability for their choices on behalf of the firm. [288] Essentially, the rule protects directors from civil responsibility arising from corporate transactions made in good faith and on a sound basis for the company's best interests in cases where the decision-maker has no personal stake in the outcome.[289] Administrators are appointed to run the debtor's business in the best interest of all stakeholders, and buying or selling is a business decision as contemplated by the business judgement rule. Furthermore, they have no personal interest in the business. I posit that administrators in partnerships or sole proprietorships or company administration can use the business judgement rule for these reasons. The administrator also raises funds for the partnership by claiming from any person who is owing to the partnership in sequestration or liquidation proceedings and obtaining dividends.[290]

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288 *Gimbel v Signal Cos.*, 316 A.2d 599, 608 (Del. Ch. 1974); *BCE Inc v 1976 Debentureholders*, 2008 SCC 69 (CanLII), [2008] 3 SCR 560. The importation of this rule into the South African Jurisprudence is adequately provided for by Lombard 2005:625; see also Du Plessis 2011:347-352; Hamadziripi and Osede 2019:27-40; Jones 2007:326-336; Lee 2005:50-84; Kennedy-Good & Coetzee 2006:62-74.

289 *Re Smith & Fawcett Ltd* [1942] Ch 304; *Overend & Gurney Co v Gibb* (1871-72) L.R. 5 H.L. 480 HL: 495. "It would be extremely wrong to import into the consideration of the case of a person acting as a mercantile agent in the purchase of a business concern, those principles of extreme caution which might dictate the course of one who is not at all inclined to invest his property in any venture of such a hazardous character. Men were chosen by the company as their directors, to act on their behalf in the same manner as they would have acted on their own behalf as men of the world, and accustomed to business, and accustomed to speculation, and having knowledge of business of this character."

290 *Insolvent Partnership order* 1994: par. 43(18). Power to rank and claim in the bankruptcy, insolvency, sequestration or liquidation of any person indebted to the partnership and to receive dividends, and to accede to trust deeds for the creditors of any such person.

4.4.2.3 Duty to litigate any action for or against the partnership

When a partnership is under administration, creditors or third parties are enjoined from suing the partnership by virtue of the moratorium.[291] However, the partnership may pursue its debtors for claims owed to the partnership. The administrator has the authority to defend or commence legal proceedings on behalf of the partnership.[292] Itis not clear whether a partner's personal claims can also form part of such proceedings. If a third party owes a partner, the administrator should initiate proceedings as creditor with the partner if the claim is intended to form part of the partnership estate.

The administrator is authorised to hire a legal practitioner in pursuance of legal proceedings on behalf of the partnership.[293] Legal proceedings may not be advised for a partnership under administration. Considering that the partnership is in financial distress, it may be advisable for the administrator to refer to arbitration any question affecting the partnership.[294]

The matters surrounding legal proceedings against or for a partnership in administration become complicated if a new partner joins the partnership or an old partner dies. *Who does the pursuer sue, the partnership or the partner?* The principle of "transmission presumption" applies. It provides that if the business taken over is practically the same as the former business and is carried on without interruption,[295] then the new partnership assumes all of the old firm's liabilities and assets. According to Lord Drummond Young, the presumption is based on one or both of novation of contractual obligations with the creditor implicitly consenting to the novation, or unilateral duty committed by the new partnership to satisfy the debts and obligations

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291 *Insolvent Partnership Order* 1994: art. 6 par. 43. See Chapter 3 for details.

292 *Insolvent Partnership Order* 1994: par. 43(5). Power to bring or defend any action or other legal proceedings in the name and on behalf of any member of the partnership in his capacity as such or of the partnership.

293 *Insolvent Partnership Order* 1994: par. 43(4). Power to appoint a solicitor or accountant or other professionally qualified person to assist him in the performance of his functions.

294 *Insolvent Partnership Order* 1994: par. 43(6). Power to refer to arbitration any question affecting the partnership.

295 *Ridway, & C.V Brock* (1831) 10 S. 105, [1831] 12 WLUK 17. In This case it was pointed that [a]s a generality, a firm which took over another business and carried it on with no outward display of change apparent to a third party would be liable for the old business's debts, the partnership was liable. see also *Heddle's Executrix v Marwick & Hourston's Trustees* (1888) 15 R. 698, [1888] 6 WLUK 2. When the whole estate of a going concern is taken over by a new partnership, the new partners contributing no capital, and the business being continued on the same footing as before, the presumption is that the liabilities are taken over with the stock, and that the new partnership undertakes liability for all the trade debts previously contracted."

of the previous partnership.[296] The courts in the UK are yet to pronounce on whether a new partnership is formed if a new partner joins the partnership while it is in administration. If a new partnership is formed, it means that the administrator can no longer represent the partnership.[297]

4.4.2.4 Duty to negotiate an arrangement

The administrator has the authority to negotiate a PVA on behalf of the partnership.[298] This approach serves time and resources for the partnership. During administration, the administrator will have first-hand information about the partnership. Hence, the administrator is better positioned to advise the court if it is necessary to summon the meeting of the creditors. At the creditors' meeting, the administrator is also able to present a proposal that he may have already agreed with the partners. If negotiations fails and creditors apply for compulsory winding up of the partnership, the administrator is authorised to defend such a petition.[299] The administrator of a partnership is empowered to do anything legal that may salvage the partnership. With the assistance of the court, it is noted that partnership administration may be the best option for South Africa.

4.4.3 Function and involvement of the court

The history of courts in England and Wales have gained a reputation of being long and complicated. Legal historians commonly traced it to the *Against Such Persons As Do Make Bankrupts Act of 1542*. According to this Act, a creditor could initiate bankruptcy proceedings by filing a complaint with one of three lords: the Lord

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296 *Scottish Pension Fund Trustees Ltd v Marshall Ross & Munro* [2018] CSIH 39. The court considered the nature and scope of the "transmission presumption", namely that a newly created partnership which took over the assets of a business was presumed to have taken over the liabilities of the business as well, where the business taken over was substantially the same and was continued without interruption.

297 Heaney 2018:7, who argued: "In my view, the best practice is to sue the partnership and partners in the partnership with which the pursuer contracted. If the partnership has been dissolved, one should sue the partners at the time of the contract. If it has continued as the same business, one might also, founding on this case, sue the present partnership and its partners."

298 *Insolvent Partnership Order* 1994: par. 43(17). Power to make any arrangement or compromise on behalf of the partnership or of its members in their capacity as such.

299 *Insolvent Partnership Order* 1994: par. 43(19). Power to present or defend a petition for the winding up of the partnership under the Insolvent Partnerships Order.

Chancellor, the Lord President, and the Lord Privy Seal.[300] The Lord Chancellor, together with the officeholders mentioned above, constituted the Court of Chancery:

> [a] quorum of … high officials [who] were empowered to dispose of all the debtor's property and to pay all the debts in full, or, at least, rateably, the property to be distributed among the creditors.[301]

While the Court of Chancery retained jurisdiction over bankruptcy concerns, bankruptcy administration was delegated to commissioners who sat as committees. These committees were in charge of making many of the decisions that are now deemed judicial. Because commissionership was frequently awarded as a kind of political patronage, most of the commissioners were not qualified to adjudicate bankruptcy cases. As a result, the system had fallen into disrepute by 1801 and was subsequently abolished.[302]

As of 1847, the bankruptcy proceedings had been formally incorporated into the High Court, with the majority of the work being performed by Registrars in Bankruptcy. However, a substantial amount of work was determined by the Chancery Division judges.[303] A possible change could have been introduced by the Cork Committee in 1982. The Cork Report suggested establishing insolvency courts with exclusive jurisdiction over all insolvency matters regardless of the person's legal status.[304]

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300 The 1542 Act, entitled *"An Act Against Such Persons as Do Make Bankrupt", "*was an involuntary proceeding initiated by the creditors in order to facilitate the complete liquidation of all of the debtor's holdings. The preamble and section I of the 1542 Act provide ample insight into how debtors of the day were perceived as well as the ramifications of being declared a bankrupt: Where divers and sundry persons craftily obtaining into their hands great substance of other men's goods do suddenly flee to parts unknown or keep their houses, not minding to pay or restore to any their creditors their debts and duties, but at their own will and pleasure consume the substance obtained by credit of other men, for their own pleasure and delicate living, against all reason, equity and good conscience … the Lord Chancellor … shall have power and authority by virtue of this Act to take … imprisonment of their bodies or otherwise, as also with their [real and personal property however held] and to make sale of said [real and personal property however held] for true satisfaction and payment of the said creditors, that is to say; to every of the said creditors a portion, rate and rate like, according to the quantity of their debt." See also Tabb 1991:331-332.

301 If the bankrupt failed to answer a summons for three months he could be declared "out of the King's protection", and his assets could be sold for the benefit of his creditors.

302 Lord Eldon is recorded in 1801 as expressing "strong indignation at the frauds committed under cover of the bankruptcy laws."

303 Bankruptcy proceedings in London were generally conducted in Lincoln's Inn and later in The Guildhall. However, the volume of work and the need for reform warranted the creation in 1832 of a permanent bankruptcy court, called the Court of Review, which removed jurisdiction from the Lord Chancellor. This was abolished in 1847 and the jurisdiction of the Court of Chancery was restored. The Registrars in Bankruptcy whose role was largely administrative when created in 1821, but which gradually developed into a judicial office, in particular after the almost total abolition of the commissioners in 1831.

304 Cork Report 1982:1003-1004 – "The court would have jurisdiction over all insolvency matters including: a. personal insolvency (other than debts arrangement orders); b. corporate insolvency; call matters relating to receivership and to administrators; d. disputes over the appointment or removal of all classes of insolvency practitioners; e. matter relating to IVAs; f. other insolvency matters specially recommended."

However, the proposal was not implemented in the IA 1986, which is the current legislation regulating insolvency law.

Insolvency or business reorganisation proceedings are currently dealt with at the Chancery Division of the High Court, which is situated in the Business and Property Court England and Wales.[305] While the phrase *Insolvency and Companies Court* is commonly known, it is not a court in the true sense of the word. In *Re Shilena Hosiery Co Ltd,*[306] the court held that:

> [t]he Companies Court is not a court separate and distinct from the High Court, with its own peculiar jurisdiction … The Companies Court is a way of describing the High Court when dealing with matters originating in the chambers of the Bankruptcy Registrar dealing with company matters, and the Companies judge is a way of describing a High Court judge when trying such matters.[307]

From this synopsis, it is clear that the English court system has some form of categorising and separates business restructuring cases from other ordinary civil cases. The sections below explore the different functions of the court in reorganisation proceedings.

4.4.3.1 Duty to protect creditors during the convening stage

The court's primary function is to protect the interests of creditors. The first instance where the court exercises its powers to protect creditors is ordering the first meeting of creditors and partners in a partnership.[308] In *Re Telewest Communications plc*,[309] it was held that the first meeting of creditors is meant to consider whether administration or liquidation would be the best option for the debtor. At the convening stage, the court is concerned with whether creditors receive notice of the first meeting[310] and adequate information about the meeting to enable them to attend the meeting.[311] Furthermore,

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305 The division of work between different levels of judge and routes of appeal are set out in the extant Insolvency Practice Direction.

306 *Re Shilena Hosiery Co Ltd* [1980] Ch 219.

307 *Re Shilena Hosiery Co Ltd* [1980]: 219.

308 *Insolvent Partnership Order* 1994: article 4. "The nominee shall, within 28 days (or such longer period as the court may allow) after he is given notice of the proposal for a IVA, submit a report to the court stating (a) whether, in his opinion, the proposed IVA has a reasonable prospect of being approved and implemented, (b) whether, in his opinion, the proposal should be considered by a meeting of the members of the partnership and by the partnership's creditors, and (c) if in his opinion it should, the date on which, and time and place at which, he proposes a meeting should be held."

309 *Re Telewest Communications* plc. No [2004] EWHC 924 (Ch); [2004] B.C.C 342.

310 *Re Indah Kiat International Finance co BV* [2016] EWHC 246 (Ch); [2016] B.C.C 418 at 29.

311 *Companies Act* 2006:sec. 987.

the court must ensure that the debtor is acting in good faith[312] and has disclosed its financial situation to the creditors. The most valuable form of protection for creditors is providing them with the full and accurate disclosure of the debtor's financial situation and the possible avenues to remedy its financial stress.[313] This information can assist creditors to spot abuse of process and determine whether the scheme is a decoy or a genuine attempt by the debtor.[314]

4.4.3.2 Duty to protect dissenting creditors

The second instance where the court intervenes to protect the rights of creditors is the sanctioning stage. At the sanctioning stage, the debtor seeks the court's approval of the proposed plan that the creditors considered and decided on during the convening stage. Creditors who voted against the voluntary arrangement may be compelled through cramdown to accept the restructuring plan.[315] This, however, increases the likelihood of abuse, especially wealth transfer from minority to majority creditors.[316] The court must intervene to ensure that the statutory requirements have been met. This includes that the proper class meetings were convened and that each class has approved the scheme by the required statutory majority. The court does not merely rubber-stamp a voluntary arrangement because its conclusion satisfies the statutory

312 *Gertner v CFL Finance Ltd* [2020] EWHC 1241 (Ch); [2020] B.P.I.R. 752; [2019] 7 WLUK 918 (Ch D); *Cadbury Schweppes PLC v Somji* [2001] 1 W.L.R. 615, [2000] 12 WLUK 610 followed (paras 34-38). The good faith rule was not a self-standing rule of the common law but an aspect of the court's statutory powers to police the approval of voluntary arrangements. See also Cahn & Livingston 2020:133-134.

313 Furthermore, the courts have emphasised the need for creditors to be provided with sufficient information to decide whether to attend the convening hearing. See *Re Van Gansewinkel Groep BV* [2015] EWHC 2151 (Ch); [2016] 2 B.C.L.C. 138.

314 *Re Van Gansewinkel Groep BV* [2015] EWHC 2151 (Ch); [2016] 2 B.C.L.C. 138.

315 *Corporations Act* 2001:sec. 411(4); *Companies Act* 2006/46:sec. 899(1); *Sovereign Life Assurance Co v Dodd* [1892] 2 QB 573, 583; *Re Hawk Insurance Co Ltd* [2002] 2 BCC 300, 306–10.

316 The majority's cramdown authority can only be used within a certain class of claimants for the purposes of schemes. Cross-class cramdown is not permitted since the legislative requirements demand approval from all claimant classes. In other words, where the plan requires the support of more than one class of claimants, the rejection of a single class adversely affects the scheme. As a result, dissenters would have an incentive to form their own class. As a result, the nature of the majority's cramdown power has been a source of claims classification disputes. Another source of contention in the same area is the rule that the court lacks authority to penalise a plan that was adopted through improperly convened class meetings. The notion of class determination is set forth in Bowen LJ's fundamental decision in *Sovereign Life Assurance Co v Dodd* and modified by Chadwick LJ in *Re Hawk Insurance Co Ltd*. That principle states that: "(i) claimants are to be classified based on the similarity or dissimilarity of their rights, as opposed to interests not derived from their class rights; and (ii) a difference in rights does not necessitate separate classes as long as the claimants can consult together with regard to their common interest." Corporations Act 2001:sec. 411(4); *Companies Act* 2006/46:sec. 899(1); *Re Hawk Insurance Co Ltd* [2002] BCC 300; *Sovereign Life Assurance Co v Dodd* [1892] 2 QB 573, 583; *Re Hawk Insurance Co Ltd* [2002] 2 BCC 300, 306–10.

requirements; instead, it further examines if the proposed arrangement is fair.[317] In *British America Nickel Corp v O' Brien*,[318] the court held the following:

> [Votes] … must be exercised subject to a general principle, which is applicable to all authorities conferred on majorities; namely, that the power given must be exercised for the purpose of benefitting the class as a whole, and not merely individual members only.[319]

In other words, although creditors may have voted for the scheme, the court is concerned with whether such exercise of power was meant to benefit all stakeholders.

4.4.3.3 Duty to preserve the integrity of moratorium

The third duty is protecting the integrity and preventing misuse of the moratorium. When a sole proprietorship or partnership applies for IVAs or PVA or PA, the moratorium is imposed against all legal proceedings.[320] While a moratorium provides the debtor with time to negotiate its arrangement or reorganisation plan, the imposition of any stay must be weighed with the need to protect individuals whose rights are suspended. The court is authorised to grant leave to commence legal proceedings against the debtor. For instance, IPO 1994, article 6, states that "[n]o step may be taken to repossess goods in the partnership's possession under a hire-purchase agreement except with the permission of the court".[321] Consequently, the court is responsible for ensuring that the statutory stay is not abused.[322] The person seeking the court's permission bears the burden of proving its case, and the court weighs the applicant's interest against the interests of other creditors of the debtor. If the court decides to grant leave, it may also stipulate the conditions for such leave.[323] While the person requesting leave will generally be required to demonstrate some form of loss, it is possible that this will not be sufficient to support the claim if a significantly greater loss would be caused to other creditors.[324] Thus, the court is faced with a delicate

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317 *Re British Aviation Insurance Co. Ltd.* [2005] EWHC 1621 (Ch); [2006] 1 B.C.L.C. 665; *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch. 213 CA and *Re English, Scottish and Australian Chartered Bank* [1893] 3 Ch. 385 CA.

318 *British America Nickel Corp v O'Brien* [1927] A.C. 369 PC.

319 *British America Nickel Corp v O'Brien* [1927]: 371.

320 *Insolvency Act* 1986:sec. 254 as amended by the *Insolvency Act* 2000: sch 3 par. 2; *Insolvent Partnership Order* 1994: art. 6, par. 43.

321 *Insolvent Partnership Order* 1994: art. 6 par. 43(3)

322 For the list of factors that the court will take into account in this exercise, see *Re Atlantic Computer Systems plc*. [1992] Ch. 505, 542-44.

323 *Royal Trust Bank v Buchler* [1989] B.C.L.C. 130, 135.

324 *Funding Corp Block Discounting Ltd. v Lexi Holdings plc*. [2008] EWHC 985 (Ch); [2008] 2 B.C.L.C. 596.

balancing exercise. On the one hand, the interests of the applicant are weighed against the interests of other creditors. On the other hand, the court must preserve the overarching purpose of the IVA and administration as envisioned by the legislature.

4.4.4 Summary

The institutional framework and role players in the UK include the office of the receiver, the administrator and the judiciary. The official receiver office provides an administrative structure for a sole proprietorship or a partner to apply for DRO or IVA. The role of the official receiver depends on the procedure that the debtor has applied to restructure its debts. When the debtor applies for a DRO, the official receiver acts as an adjudicator. In this capacity, the official receiver evaluates the debtor's financial situation and either grants or rejects the debtor's application. Allowing the official receiver to act as a magistrate reduces legal costs for debtors because they do not need to approach the court for a DRO. The official receiver may also be appointed as a supervisor of an IVA. In this capacity, the official receiver assists the debtor to prepare and present a rearrangement proposal to creditors. If the creditors approve, the official receiver also oversees the implementation of the IVA. If the debtor is not satisfied with the official receiver's decisions, the debtor can apply to the court to review the official receiver's decision. South Africa should consider setting up such an administrative institution because it is accessible, cheap and time-effective for a debtor. The official receiver office distances the debtor from the court and facilitates negotiations with creditors that are not costly for the debtor.

The role of the administrator in the UK is almost the same as the BRP in South Africa. These two jurisdictions share the same approach when a debtor is admitted to administration or business rescue. When under administration, the debtor is replaced by the administrator, while the BRP also replaces the board of directors in business rescue. The legislature in South Africa may find the modified duties of the administrator in the IPO useful and directive when dealing with a partnership admitted to business rescue. IPO 1994 provides a revised list of the administrator's duties when dealing with an insolvent partnership. In terms of the IPO, the administrator must take over the management of the partnership and locate the partnership property. After assessing the financial situation of the debtor, the administrator is authorised to seek further post-commencement finance. This may be achieved by selling some of the partnership

property or pursuing some of the partnership debtors. If any proceedings are commenced against the partnership, the administrator is authorised to appoint an attorney. Furthermore, the administrator is authorised to negotiate a PVA with creditors. Essentially, the administrator becomes an agent of the partnership.

Unlike the United States, the court system in the UK does not have a specialised court for insolvency and a business rescue court, but has a division in the High Court responsible for such cases. There is some form of separation of insolvency and reorganisation cases from ordinary civil cases. The court's involvement in the UK is that of a distant observer, but in some instances, it is involved at every stage, especially IVAs and PVAs. In these cases, the court summons the meeting of creditors. After the meeting, the court must ensure that the dissenting creditors are not unfairly treated. During the implementation of any procedure, a creditor may approach the court for leave to sue the debtor. In such a situation, the court must balance the interests of the creditor and that of others, considering the legislature's intention to rehabilitate the debtor. In summary, the institutional structure and legislation in the UK provides South Africa with a mind map of integrating partnerships into the Chapter 6 rescue or promulgating new rescue legislation for UBEs. The section that follows examines the approach in Kenya.

4.5 KENYA

The institutional framework of business rescue in Kenya evolves around three main organs: the Office of the Receiver, IPs and the courts. The official receiver's role changes from time to time; at one point, the official receiver is appointed as a supervisor of the rescue proceedings. At another point, the official receiver is empowered to act as an adjudicator. IPs are essentially the BRPs in Kenya. Their functions as supervisors involve assessing the debtor's financial status, convening the creditors' meetings, and overseeing a rescue plan. The intervention of the courts in alternative bankruptcy procedures is visible in the IVAs. There are no specialised bankruptcy courts in Kenya, therefore, most of the applications for IVAs are made to the high court. The court has jurisdiction to make an interim order, adjudicate any objections by the creditors and preside over allegations of false representation against the debtor. This section explains the functions of each organ to note practices that can be adopted in the proposed institutional framework.

4.5.1 Office of the Official Receiver in Insolvency

As discussed above, the concept *office of the official receiver* is derived from English law.[325] This official receiver is an independent board responsible for the development of insolvency legislation and policies.[326] It has the power to regulate and supervise IPs in Kenya. Its principal function is to oversee the administration, rescue and liquidation of financially distressed companies. Furthermore, it has the power to investigate the behaviour of any debtor, whether natural or juristic person, who are subject to the IA 2015.

Although Kenya borrowed this idea, the official receiver's function under the IA 2015 is dependent on the rescue procedure applied for by the debtor.[327] If the debtor chooses individual IVAs[328] and expedited procedure,[329] the official receiver may be appointed as a supervisor, whereas the official receiver steps in as an adjudicator if the debtor applies for a summary instalment order.[330] If the debtor chooses to commence the no-asset procedure,[331] the official receiver can adjudicate any matter arising from the application and act as the supervisor. This section explores the different roles of the official receiver in the rescue of sole proprietorships and partnerships under IA 2015.

4.5.1.1 Duty to supervise the expedited procedures

A sole trader or general partnership may nominate the official receiver as supervisor of an individual IVA or expedited procedure. This exposition of the official receiver's duty as a supervisor will be restricted to its duties under expedited procedures.[332] If a debtor wishes to make a proposal to its creditors and has identified the official receiver

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325 Too 2016:93; Goode 2011:149-176.

326 "The Office of the Official Receiver in Insolvency is established under the Insolvency Act, 2015, as the Official Receiver in Insolvency. The office is a department under the Business Registration Service, a Semi-Autonomous Government Agency under the office of the Attorney General & Department of Justice" (Republic of Kenya, Office of the Attorney General and Department of Justice). This means that official receivers are salaried individuals of the government, they do not derive personal profit from administering the estates of debtors.

327 *Insolvency Act* 2015: Part VI.

328 *Insolvency Act* 2015: Part VI, Division 1.

329 *Insolvency Act* 2015: Part VI, Division 2.

330 *Insolvency Act* 2015: Part VI, Division 3.

331 *Insolvency Act* 2015: Part VI, Division 4.

332 See 4.2.3.2 Insolvency Practitioners.

as its provisions supervisor, such debtor may apply for an expedited procedure.[333] The official receiver is mandated to assess the debtor's proposal and determine if the plan is feasible.[334] If the official receiver considers the debtor's proposal to be feasible and practical, then a meeting with creditors is convened to consider such a proposal.[335]

The official receiver must communicate with all known creditors about the meeting.[336] It seems to be the most efficient method to communicate with creditors. The official receiver has the financial and human resources to effectively communicate and serve creditors, compared to an individual or partners in a partnership. It is presumably the duty of the official receiver to reject any suggestions for modifications of the debtor's proposal. I posit that allowing the official receiver to step into the debtor's shoes protects the debtor from creditors such as bankers who may have undue influence in the proceedings. Allowing creditors to communicate with the debtor directly may result in the debtor being forced into accepting modifications that may bankrupt his business.

The official receiver must inform the court of the debtor's circumstances after the creditors' meeting.[337] The debtor does not have to appoint a lawyer because the official receiver is considered an officer of the court. This also reduces the debtor's legal costs. When the debtor's proposal has been approved, the agreement becomes an order of the court. In cases where the debtor is an undischarged bankrupt, the official receiver has the authority to apply for the annulment of the bankruptcy order.[338] Generally, engaging the official receiver in expedited processes saves time and money for the court, creditors, and the debtor.

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333 *Insolvency Act* 2015:sec. 316(1)(b).

334 *Insolvency Act* 2015:sec. 316(3).

335 *Insolvency Act* 2015:sec. 316(3).

336 *Insolvency Act* 2015:sec. 316(5). "In making arrangements under subsection (3), the Official Receiver shall ensure that– (a) each creditor is provided with a copy of the debtor's proposal; (b) each creditor is provided with information about the criteria by reference to which the Official Receiver will determine whether the creditors approve or reject that proposal; and (c) no opportunity is allowed for modifications to that proposal to be suggested or made."

337 *Insolvency Act* 2015:sec. 317: "As soon reasonably practicable after the arrangements under section 316 have been implemented, the Official Receiver shall report to the Court whether the proposed IVA has been approved or rejected."

338 *Insolvency Act* 2015:sec. 319.

4.5.1.2 Duty to adjudicate summary instalment orders

When a debtor applies for summary instalment orders, the official receiver has the authority to make such an order.[339] When considering such an order, the official receiver must hear representation from both the creditor and the debtor.[340] It essentially endows the official receiver with adjudicative authority. Empowering the official receiver with adjudicative powers reduces the workload for courts and expenses for litigants such as entrepreneurs. The process is convenient, cost-effective and swift.

The official receiver has the power to make summary instalment orders and has the authority to make orders incidental to the summary instalment order. In terms of section 327:

> In addition to an order for the payment of the debts in instalments, the Official Receiver may make all or any of the following orders: (a) an order regarding the debtor's future earnings or income; (b) an order regarding the disposal of goods that the debtor owns or possesses;(c) an order giving the supervisor appointed under section 328 power (i) to direct the debtor's employer to pay all or part of the debtor's earnings to the supervisor; and (ii) to supervise payment, out of the debtor's earnings or income, of the reasonable living expenses of the debtor and the debtor's relatives and dependants.[341]

This enables easy administration of the debtor's affairs, especially if the debtor is a member of a UBE. The debtor does not necessarily need to go to court for issues such as maintenance orders and garnishing orders. The official receiver may require the supervisor or previous supervisor to provide documents pertaining to the debtor.[342] Failure to provide such documentation may attract a fine of up to 250 000 Kenyan shillings.[343] The question can be asked: *Does failure to provide documents related to a debtor requested by an official receiver amounts to contempt of court?* Courts in Kenya have not yet determined this issue, but I foresee that supervisors may challenge the authority of the official receiver to find any person guilty of contempt of court. It is also not clear which court has jurisdiction to hear matters concerning offences by the

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339 *Insolvency Act* 2015:sec. 323: "A summary instalment order is an order made by the Official Receiver directing the debtor to pay the debtor's debts– (a) in instalments or in some other way; and (b) in full or to the extent that the Official Receiver considers practicable in the particular circumstances of the case."

340 *Insolvency Act* 2015:sec. 326(2) stipulates that "the Official Receiver may not make such an order without having given the debtor and the creditors an opportunity to make representations with respect to the matter." In accordance with *Ex parte James* [1874] LR 9CH 609 the official receiver is under a duty to be fair, principled, and honourable.

341 *Insolvency Act* 2015:sec. 327.

342 *Insolvency Act* 2015:sec. 330.

343 *Insolvency Act* 2015:sec. 330(2).

debtor. I opine that the high court has the authority to determine whether the debtor is guilty of contravening IA 2015. The official receiver does not have jurisdiction to hear criminal offences such as contempt of court, fraud or extortion, or laundering arising from administering business rescue.

4.5.1.3 Duty to administrate the no-asset procedure

A debtor may apply to the official receiver to be admitted for the no-asset procedure.[344] This procedure is different from summary instalment orders in that there is no need for representation. The official receiver's decision under the no-asset procedure is purely administrative. If the decision is disputed, the creditor must petition the High Court to review the order. The official receiver may therefore only admit a debtor to the no asset procedure if there are reasonable grounds to believe that the debtor's estate or business can be rehabilitated.[345]

After making such an order, it is the responsibility of the official receiver to inform all known creditors of the debtor's admission to the no-asset procedure.[346] The communication from the official receiver is essential in that creditors should not continue extending credit to the debtor.[347] The official receiver also has the authority to terminate the no-asset procedure.[348] In cases where the debtor has provided false information or misled the official receiver, the official receiver can terminate the proceedings.[349] The official receiver may also exercise its powers to terminate the no asset procedure if the debtor's circumstances have changed to the effect that the debtor can now pay its creditors.[350] If the official receiver terminates the no-asset procedure based on the fact that the debtor hid valuable assets, the official receiver

344 *Insolvency Act* 2015:sec. 344.

345 *Insolvency Act* 2015:sec. 345(1). "In making a decision for or against the debtor; the official receiver must take a several factors into consideration including section 345(1) which states that no-asset that (a) the debtor has no realisable assets; (b) the debtor has not previously been admitted to the no-asset procedure; (c) the debtor has not previously been adjudged (d) the debtor has total debts that are not less than one hundred thousand shillings and not more than four million shillings; and (e) the debtor does not have the means to repay any amount towards those debts."

346 *Insolvency Act* 2015:sec. 347. "As soon as practicable after receiving an application from a debtor for entry to the no-asset procedure, the Official Receiver shall send a summary of the debtor's assets and liabilities to each known creditor of the debtor."

347 *Insolvency Act* 2015:sec. 352(3).

348 *Insolvency Act* 2015:sec. 355.

349 *Insolvency Act* 2015:sec. 355(1)(a): "The Official Receiver shall terminate a debtor's participation in the no-asset procedure if satisfied- (a) that the debtor was wrongly admitted to the no-asset procedure (for example, because the debtor concealed assets) or misled the Official Receiver."

350 *Insolvency Act* 2015:sec. 355.

has *locus standi* to apply to the high court to preserve the debtor's estate, pending bankruptcy proceedings.[351]

4.5.2 Insolvency practitioners

The IA 2015 created the profession of IPs.[352] The main purpose of an IP is to provide guidance and oversee the liquidation or administration or supervision of debtors. In the case of *In re Winding up of Karuturi Limited*,[353] J Ochieng observed that:

> [t]he new law brings into play the person called an insolvency practitioner, who is then authorized to be the liquidator *(whether provisional or substantive)* or the administrator of a company or a supervisor of a VA which had been duly approved.[354]

Only an authorised IP is eligible to supervise the rescue of sole traders, partnerships and companies.[355] It means that the IP essentially monitors alternative bankruptcy procedures that require the services of a supervisor.

The functions of the IP have been established to maximise the value of the debtor's estate or assets. On the one hand, if the debtor is insolvent and there is no likelihood that its financial affairs can be recovered for the benefit of creditors, the IP steps in as a liquidator. The liquidator is called upon to maximise the value of the debtor and increase returns for creditors. On the other hand, where there is a reasonable belief that the debtor can be rescued and operate its business on a solvent basis, the IP is mandated to implement and supervise a rescue plan. The IP's profession provided in the IA 2015 can best be compared to a pathologist and sergeant profession. As a coroner, the IP investigates the causes for the debtor's insolvency which resulted in its dissolution. In other words, the IP conducts an analysis of the debtor's financial affairs before distributing the remains of its value to creditors. Whereas, as a sergeant, the IP is called upon to operate a debtor on the verge of insolvency. The IP attempts to resuscitate the debtor by reorganising its business or selling it as a going concern. This is essentially a modernised approach to realise the promotion of using alternative bankruptcy procedures to solve the problems between creditors and debtors rather

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351 *Insolvency Act* 2015:sec. 356(1). "If the Official Receiver terminates a debtor's participation in the no-asset procedure on the ground that the debtor has concealed assets or misled the official receiver, the court may, on the application of the official receiver, make an order for the preservation of the debtor's assets pending an application for the debtor's bankruptcy."

352 *Insolvency Act* 2015:sec. 4 (a); Nikira 2015:19; Shaw 2019:50.

353 *In re Winding up of Karuturi Limited* [2016] Eklr.

354 *In re Winding up of Karuturi Limited*: 8.

355 *Insolvency Act* 2015:sec. 4(c); *Rajendra Ratilal Sanghani v Schoon Ahmed Noorani* [2018] eKLR: 6.

than liquidation.[356] The following section discusses the requirements for an IP to serve as a supervisor or administrator. It further explores their role during the rescue or rehabilitation of sole traders and partnerships.

4.5.2.1 Requirements for appointment as supervisor

The IP envisaged by theIA 2015 must have experience and knowledge in business, law and accounting. For this reason, an IP should be a certified member of a recognised body, either the Law Society of Kenya or the Institute of Public Accountants.[357] The IP must further provide a professional indemnity insurance cover of Kenyan shillings. Twenty-five million or more, and security in the form of a bond of 5 000 000 Kenyan shillings, which must be delivered to the office of the official receiver.[358] Considering the amount of money required for indemnity and security bonds, it is reasonable that a natural person cannot be an IP if he is adjudged bankrupt[359] or unable to perform the duties of an IP due to mental or physical infirmity.[360] A company is also not eligible to be appointed as an IP;[361] however, the Act does not prohibit employees of a corporate body from practising as IPs.

The *Insolvency Regulations* 2016 provides a list of requirements for a candidate to become an IP: the applicant must at least have a recognised university degree,[362] five years of professional experience,[363] at least two years of experience in the insolvency practice,[364] must have worked under the apprenticeship of an IP for a minimum of four years[365], and must meet the requirements of Chapter 6 of the Kenyan Constitution.[366]

The Act does not automatically recognise qualified IPs as supervisors. A nominee supervisor or liquidator must apply to the Official Receiver office.[367] It seems as if the qualifications of a liquidator are far different from that of a supervisor or a BRP.

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356 Mugo 2015:6-8; Njihia 2015:27.

357 Insolvency Regulations 2016: reg 11(5).

358 *Insolvency Regulations* 2016: reg 11(6). (25 000 000 Kenyan shillings is approximately R3 844 663 and 5 000 000 approximately R768 985).

359 *Insolvency Act* 2015:sec. 6(2) (a).

360 *Insolvency Act* 2015:sec. 6(2) (b).

361 *Insolvency Act* 2015:sec. 6 (3).

362 Insolvency Regulations 2016: reg 11(1)(a).

363 Insolvency Regulations 2016: reg 11(1)(b).

364 Insolvency Regulations 2016: reg 11(1)(c).

365 Insolvency Regulations 2016: reg 11(1)(d).

366 Constitution of the Republic of Kenya 2010:sec. 73-80.

367 *Insolvency Act* 2015:sec.8(1). “A person who wishes to act as an insolvency practitioner may apply to the Official Receiver for an authorisation to act as an insolvency practitioner for the purposes of this Act.”

Although there is a thin line between their functions, the consequences of their actions are far-reaching. Cassim *et al* argued that "the requisite skills of a liquidator are quite different from the expertise of a turnaround expert, and conversely. A liquidator is a specialist in dismantling a company – not rescuing it."[368] Therefore, it is commendable to preclude a liquidator from being appointed as a supervisor of a company in financial distress.

Scholars and practitioners in Kenya observed that business debtors prefer appointing accountants as supervisors to lawyers.[369] Njihia states that:

> There is a general presumption that accountants are better placed to handle rescue since they are "men of business". Within the field of corporate rescue, there is an understanding that an IPs primary role is to analyze data and suggest conclusions for decision making based on the findings which are basically what accountants practice, thus leaving most administrations to accountants over lawyers. Hence in practice, the overriding factor is statistical analysis leaving legal considerations as a second thought.[370]

This observation bolsters the idea that liquidators cannot be appointed as supervisors. Accountants have knowledge and experience in financial engineering, including business analytics, financial data analytics and risk management. These are essential tools for business rescue. In contrast, lawyers specialise in the allocation of rights and obligations akin to the functions of a liquidator. A liquidator is called upon to distribute the remains of the debtor assets to creditors. I posit that allowing IPs to act as liquidators and supervisors is asking too much from the practitioners who have too little to offer. I strongly recommend that lawyers should be appointed as liquidators while accountants are appointed as supervisors. In cases where an attorneys want to practice as a supervisor, they must first gain knowledge and experience in business and accounting. Generally, the profession of BRPs should be separated from that of liquidators.

4.5.2.2 Duty to prepare a report for the court

Section 307 of the IA 2015 provides that the provisional supervisor prepares a report to the court stating its findings on the debtor's position as soon as practical after receiving an interim order.[371] The supervisor should establish whether the debtor's

368 Cassim et al 2012:895.
369 Njihia 2015:37-38.
370 Njihia 2015:37.
371 *Rajendra Ratilal Sanghani v Schoon Ahmed Noorani* [2018] eKLR: 24.

proposal has reasonable prospects of being approved by the majority of creditors and that it can be effectively implemented. Alternatively, the supervisor should advise the court if a meeting of the debtor's creditors should be convened to consider the debtor's proposal. In this regard, the supervisor should provide the court with the date, time and place where the meeting can be held.

The primary purpose of this exercise is to evaluate how severe the debtor's financial problems are and whether the proposal is feasible and the supervisor takes on the role of a court-appointed advisor. As such, the IP's opinion must be accurate. If the supervisor is of the view that the debtor is not feasible, the court should be advised that the debtor should be liquidated. However, the IA 2015 does not restrict a supervisor from being appointed as a liquidator. The legislature should consider inserting a provision to prevent the appointment of the same IP appointed as supervisor to be a liquidator. This approach prevents the supervisor from benefitting a second fee if appointed as a liquidator. Besides, if the court directs that the debtor's estate should be sequestrated, then the supervisor becomes a preferential creditor. This gives rise to a conflict of interests if the supervisor is also appointed as the liquidator.

4.5.2.3 Duty to negotiate in good faith.

A supervisor appointed to oversee the implementation of an IVA has the authority to negotiate with the creditors to accept the debtor's proposal as it is or modified. *In re of Uchumi Supermarkets Plc,*[372] the court ordered the supervisor to negotiate with the debtor's proposal. In that case, the creditors rejected the debtor's proposal and applied for the debtor's liquidation. The court ruled that the new Act had a variety of alternatives to bankruptcy, including IVAs. The court further held that the supervisor should negotiate with creditors in good faith.

It should be borne in mind that an IP is nominated by the debtor, and creditors may object or accept the debtor's nomination. This places the supervisor in a position of trust, which requires honesty and truthfulness. On the one hand, the supervisor should

[372] *In re of Uchumi Supermarkets Plc* [2019] eKLR: 18 Kasango J: "[i]n the interest of justice I will permit the company and the supervisor, Owen Njenga Koimburi, to further engage the secured creditors with a view to presenting another CVA which, in accordance with section 626 (2) of the *Insolvency Act* will be submitted before court. In presenting the report to court a date will be set for the meeting of the company and the company's creditors."

not exaggerate the debtor's prospects of success. Furthermore, if the supervisor decides to amend the voluntary arrangement, the amendments should not be calculated to prioritise his administration fees to the detriment of other creditors. On the other hand, the supervisor must keep sensitive trade information confidential. For instance, the debtor's trade secrets or client list must not be disclosed to its competitors, who may be creditors.

4.5.3 Commercial and admiralty division

The IA 2015 specifies that issues concerning alternatives to bankruptcy and insolvency are dealt with at the High Court. According to section 1, "the Court" means "the High Court, and if there is an insolvency division of that Court, it means that division".[373] The High Court in Kenya is established in terms of article 165 of the Constitution.[374] In a normal hearing, the court is duly constituted by one presiding officer. However, complex cases require two or more judges. The Head of State (the President) appoints judges advised by the Judicial Service Commission.[375] The High Courts are divided into four different divisions.[376] The focus of this study is the commercial and admiralty division. The commercial and admiralty, also known as the commercial and tax division, is responsible for restructuring and insolvency proceedings.[377] Since the qualifications for being appointed as a judge are mainly focused on educational qualifications, experience as a practitioner and judge, it seems that appointment to hear matters on restructuring and insolvency follows the same route. It makes sense that judges with experience in business rescue and insolvency procedures as practitioners are appointed to preside over such matters.

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373 *Insolvency Act* 2015:sec. 1.

374 Constitution of the Republic of Kenya 2010: art 165; Thiankolu 2019:53.

375 "To qualify for appointment, the prospective judge must: have been a judge of a court having unlimited jurisdiction in civil and criminal matters in the Common Wealth or in the Republic of Ireland or having jurisdiction in appeals from such a court; or Be admitted as an advocate of the High Court of not less than seven years standing; He /she holds and has held for a period of or periods amounting in aggregate to not less than seven years, one or other of the qualifications specified in Section 12 of the *Advocates Act. Advocates Act* : sec. 12 Qualification for admission as advocate: Subject to this Act, no person shall be admitted as an advocate unless— (a) he is a citizen of Kenya, Rwanda, Burundi, Uganda or Tanzania; and (b) he is duly qualified in accordance with section 13."

376 Division of Judicial Review. Division of Land and Environment: responsible for making rulings on issues of sustainable development and equitable distribution of resources. Division of Commercial and Admiralty: adjudicates commercial disputes, insolvency proceedings and reduce the transaction costs of justice for the private sector. Division of Constitution and Human Rights: acts as the court of first instance in constitutional cases; interpreting and enforcing Bill of Rights.

377 Hussein 2003; Jackson 1992; Ogola 2005.

Alternatives to bankruptcy mainly depend on the official receiver, but the legislature allowed the courts to be involved. During the application and implementation of alternatives to bankruptcy, the involvement of the court may be divided into three categories: intervention, mediation and adjudication. *Intervention* refers to the court's interference in the proceedings and determining on behalf of one part or both parties. *Mediation*, in this case, means that there are instances where the court is called upon to act as a mediator between the debtor and its creditors or between creditors. However, if the debtor is accused of contravening the Act, the court has the authority to *adjudicate* the matter. The following subsections provide an in-depth discussion of the involvement of the court.

4.5.3.1 Authority to intervene and give directives

Alternatives to bankruptcy are informal proceedings in nature.[378] They are meant for parties to engage without involving the court. However, the court can intervene. Under the individual IVA, the court has the power to issue an interim order in terms of section 306.[379] A debtor may apply to the court for an interim order for creditors to consider its proposal for an individual IVA. In terms of section 306(2), the "Court shall make an interim order if satisfied that it would facilitate the consideration and implementation of the debtor's proposal."[380] If the plan is feasible, the court has the authority to order creditors to consider the debtor's proposal; whereas, if the plan is not feasible, the court can order the debtor to begin liquidation proceedings.

It is important to state that the court has no authority to force creditors to accept the debtor's proposal. This feature is different from the cram-down approach in the United States[381] and the UK.[382] The advantage of limiting the court's involvement is that the debtors do not necessarily need to pay the cost of the proceedings.[383] If the debtor has been declared bankrupt, but through expedited proceedings, secures an

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378 Garrido 2012, para. 1:1.

379 *Insolvency Act* 2015:sec. 306(1).

380 *Insolvency Act* 2015:sec. 306(2).

381 *Bankruptcy Code* 2005:sec. 1129(16)(b)(1).

382 *Insolvency Act* 1986:sec. 260.

383 Armour & Cumming 2008:303; Davydenko & Frank 2008:565; La Porta ***et al*** 1998:1113, 2002:1147; Pak & Pfister 2013:1.

agreement with its creditors, the court can annul the bankruptcy order.[384] Only a court can annul a court order. Thus, the court's intervention in this instance is reasonable and consistent with the separation of powers.[385]

The court may intervene as an advisor to the proceedings. Section 318(5) provides that "the Court may give such directions about the conduct of the bankruptcy and the administration of bankrupt's estate as it considers [it] will facilitate implementation of the approved IVA".[386] Allowing the court to provide directives on the treatment of the debtor is a fundamental innovation of the institutional structure. The court may decide how the debtor estate can be administered while implementing an IVA. In essence, although UBEs do not have legal personality, a court order can effectively enjoin creditors from commencing legal proceedings against entrepreneurs or their spouses.

4.5.3.2 Authority to hear procedural irregularities

The court has the authority to declare any material breach of the procedures inconsistent with the Act. I posit that judges are experienced lawyers who understand procedural law; thus, they are appropriately qualified to determine if the breach is material or minor. The authority to hear procedural matters is only confined to the courts and cannot be deferred to the office of the official receiver. The official receiver only acts as an administrator and not an adjudicator in the same way as judges.

When disputes arise between creditors and the debtor, the court becomes involved as a mediator. As a mediator, the court must evaluate the interests of both creditors and that of the debtor.[387] In section 314, the legislature accepted that disagreements can arise and that valid objections should not be ignored. Thus, the court's role is to provide an independent assessment of the debtor's proposal and identify areas that can be modified. In cases where creditors raise unfounded objections, the court is allowed to

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384 *Insolvency Act* 2015:sec. 318 (4). "On considering an application made by the Official Receiver the Court shall annul the bankruptcy order in respect of the debtor unless it is of the opinion that there are compelling reasons not to do so."

385 *County Government of Kiambu & another v Senate & others* [2017] eKLR; *Speaker of the Senate and Another vs. The Hon. Attorney General and 3 Others*, Advisory Opinion Reference No. 2 of 2013: under the doctrine of separation of powers, the judiciary has no legitimate business to intervene in matters falling within the legislative competence of parliament.

386 *Insolvency Act* 2015:sec. 318(5).

387 *Insolvency Act* 2015:sec. 314 (1) states that "any of the persons specified in subsection (2) may make an application to the Court on either or both of the following grounds: (a) that a debtor's proposal approved by a creditors' meeting held in accordance with section 309 unfairly affects the interests of a creditor of the debtor; (b) that a material irregularity occurred at or in relation to the meeting."

cramdown such creditors.[388] Secured creditors must have been paid, and that the implication of the cramdown must not leave dissenting creditors in a worse position than they would have been if the debtor was liquidated.[389] The courts should use their power to compel secured creditors to carefully consent to a reorganisation plan. I am of the opinion that an injudicious application of cramdown provisions may result in the encroachment of the freedom of contracting and violating the sanctity of contracting. These are the principles based on contracting and must be observed during the negotiations of a restructuring plan. The courts should only interpose where it's necessary and in the interest of justice.

4.5.3.3 Authority to criminal matters

IA 2015 stipulates that there are actions by the debtor that may constitute offences punishable by a fine or imprisonment.[390] For example, section 321 states that a debtor commits an offence if he makes a false or deceptive representation to obtain a voluntary arrangement' approval. A person found guilty of this offence faces a maximum fine of two million shillings or a maximum term of five years in jail. [391] In this regard, the court has the authority to hear criminal matters.[392]

In *Republic v Karisa Chengo & 2 others,* the legal question was whether special courts such as the High Court (Commercial and Admiralty Division) had the jurisdiction to hear criminal matters. The Supreme Court of Appeal held that "the jurisdiction of Courts is derived from the Constitution or legislation".[393] Although this division is mandated to hear business rescue and bankruptcy matters, it has an inherent jurisdiction to hear offences outlined in IA 2015 and common law.

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388 *Insolvency Act* 2015:sec. 311(8). "The Court may make an order under subsection (7)(a) even if the debtor's proposal (or a modification to it) was not approved at the creditors' meeting by a majority of the preferential creditors' group or the unsecured creditors' group, but may do so only if the proposal (or modification–- (a) has been approved by a majority of the secured creditors' group; (b) does not discriminate among the members of the dissenting group or groups of creditors and ensures that they will be no worse off than they would have been if the debtor had been adjudged bankrupt; and (c) respects the priorities of preferential creditors over unsecured creditors."

389 *Insolvency Act* 2015:sec. 311(8).

390 *Insolvency Act* 2015:sec. 321, 342.(l). A debtor in respect of whom a summary instalment order is in effect commits an offence if, before all creditors have been paid the amounts to which they are entitled under the order.

391 *Insolvency Act* 2015:sec. 321.

392 *Republic v Karisa Chengo & 2 others* [2017] eKLR at E [32].

393 *Republic v Karisa Chengo & 2 others* [2017] eKLR at [51]; In re the Matter of the Interim Independent Electoral Commission: at paras. 29 and 30.

On the same note, there is no relationship between IA 2015 and section 50 of the Constitution of Kenya 2010. That section guarantees an accused person's right to a fair trial.[394] Therefore, a debtor charged with contravening IA 2015 is entitled to the constitutional rights in section 50, and the court hearing the matter must ensure that these rights are observed. More importantly, section 25(c) of the Constitution stipulates that the right to a fair trial cannot be limited.[395] It implies that the offences in IA 2015 should be prosecuted without infringing the debtor's right to a fair trial. The legislature should consider inserting a section that connects IA with legislation dealing with prosecution of offenders, including the *Criminal Procedure Code* 2012.[396]

4.5.4 Summary

The study revealed that Kenya has three main institutions that facilitate the recovery of sole proprietorships and partnerships. If the debtor is a sole proprietorship, the office of the official receiver facilitates most of the debt relief schemes. However, if the debtor is a partnership, the Ips and the court are more involved in the resuscitation of the debtor.

The duties of the official receiver depend on the type of debt relief schemes. The debtor may appoint the official receiver as nominee or supervisor of an expedited individual arrangement. In this regard, the main duty of the official receiver is to assist the debtor in preparing a rescue plan and overseeing its implementation. If the debtor applies for a summary instalment order, the official receiver's duty is to adjudicate over the application. If the debtor applies for no-asset procedures, the official receiver must administrate the case. South Africa should consider an institution similar to the office of the official receiver because it is easy for debtors to access, and the government may subsidise the rescue procedure.

The IP's role may be that of supervisor of IVAs. In this position, the IP assists the debtor to prepare a rearrangement plan and negotiating with creditors. Regarding the qualifications of an IP, any person who is qualified as an attorney, accountant or business practitioner can be appointed as a supervisor. It appears that debtors in

394 *Constitution* 2010:sec. 50(1) and (2): "Every person has the right to have any dispute that can be resolved by the application of law decided in a fair and public hearing before a court or, if appropriate, another independent and impartial tribunal or body. Every accused person has the right to a fair trial."

395 *Constitution* 2010:sec. 25(c): "Despite any other provision in this Constitution, the following rights and fundamental freedoms shall not be limited, (c) the right to a fair trial."

396 *Criminal Procedure Code* Chapter 75 revised in 2012.

Kenya prefer to appoint accountants over lawyers. The main reason is that accountants have the knowledge and experience in finances, whereas lawyers are more focused on rights and obligations. South Africa may enhance its system by incorporating accounting modules for candidate attorneys.

Kenya does not have independent insolvency and business rescue courts. However, they established the commercial and admiralty division as the court responsible for any case pertaining to insolvency and business rescue issues. Alternatives to bankruptcy are informal proceedings in nature; hence the involvement of the courts is to a minimum. The court intervenes where a debtor applies for an interim order to commence an IVA. Furthermore, the court has the authority to hear any procedural irregularities such as irregularities during creditors' meetings. Ultimately, the court has jurisdiction to hear civil and criminal matters that arise during the rescue procedure. The Kenyan institution framework suggests that it is necessary to establish a specialised court specifically dealing with insolvency and business rescue.

4.6 CONCLUSION

There are three main participants in the business rescue process. These actors include the debtor, the BRP (administrator, trustee or official receiver) and the judge.

In South Africa, it appears that the debtor surrenders its business to the BRP. However, before business rescue begins, the debtor should commence business rescue before the business becomes insolvent. While the business is under restructuring, the debtor is required to cooperate with the BRPs. In other words, the debtor should perform all the duties as directed by the practitioner. Furthermore, the debtor should provide the practitioner with the necessary information and documentation for the recovery of the business. Basically, the debtor is required to act in good faith and in the best interest of the business. The United States business reorganisation scheme provides an elaborate example of the duties of a sole proprietorship or a partnership in business rescue. Chapter 13 provides that if the debtor is an owner of the business, the debtor remains in possession and should regularly report to the trustee and the court. If the debtor is a partnership, Chapter 11 provides that the managing partner remains in charge of the partnership business. All partners have a fiduciary duty to the partnership and stakeholders. The partners are required to contribute to the restructuring process. As provided by the Bankruptcy

Code, the debtor-in-possession approach requires the debtor to continue managing the business to generate profit. Furthermore, the debtor may enter into new financial agreements for purposes of recovering the business. More importantly, the debtor must report all its activities to the trustee and the court. In the UK and Kenya, where the debtor surrenders its business to the rescue practitioner, it seems that the debtor's duties are similar to those provided by Chapter 6 of the South African business rescue scheme. A business rescue procedure for sole proprietorships and partnerships should determine whether the debtor remains in control of its business or surrenders it to the practitioner.

The role of the BRP in the rescue process depends on whether the rescue procedure allows the debtor to remain in possession or surrender its business to the BRP. In South Africa, the BRP takes over the management of the company. The practitioner is then required to investigate the affairs of the debtor to establish the cause of insolvency. In addition, the practitioner should prepare a business rescue plan and foresee its implementation. It is the practitioner's duty to update all affected persons on the progress of business rescue, including submitting monthly reports to the court especially where business rescue exceeds the prescribed period. In the United States, the trustee plays the role of the BRP in the rescue of UBEs. The role of the trustee is that of an observer and advisor. The Chapter 13 trustee deals with sole proprietorships in business rescue, and his duties include appearing in court on behalf of the debtor. Furthermore, investigating the debtor's affairs and reporting to the court. The trustee ensures that the debtor implements the reorganisation plan and pays the creditors. With regard to partners, the Chapter 11 trustee follows up on each partner for their contribution. The appointment of a trustee in reorganising a partnership is made by way of an application to the court. The petitioner must show that the appointment is necessary because there is reason to believe that the partners committed a crime such as fraud or that it is in the best interest of creditors to appoint a trustee.

In the UK and Kenya, the official receiver and the administrator are regarded as the BRP. The official receiver assists sole proprietorships, and the administrator oversees the rescue of the partnership. If the debtor applies for a DRO, the official receiver adjudicates the matter; if the debtor applies for an IVA, the official receiver can be appointed as the supervisor. If the debtor applies for administration in the UK and Kenya, it must surrender its business to the administrator. The role of the administer

is akin to the role of the BRP in South Africa. However, there are significant differences. The administrator takes over the management of the partnership but is not allowed to hire or dismiss partners. Nonetheless, the administrator has several rights and responsibilities, including locating the partnership property, continuing the business, outsourcing finances and negotiating with creditors. If creditors apply for the winding up of the partnership, the administrator is authorised to defend. In this regard, the administrator may appoint an attorney or negotiate with stakeholders for a voluntary arrangement. A business rescue scheme that applies to sole proprietorships should consider a debtor-in-possession approach and a BRP must comply with the same duties as that of a trustee under the Bankruptcy Code of the United States. However, partnerships should surrender their businesses to the BRP. The practitioner may discharge the duties of an administrator as presented in the UK approach.

The study further showed that the court is also indispensable to the effectiveness of any business rescue procedure. In South Africa, the court is involved from commencement of business rescue where an affected person applies for compulsory business rescue. In this regard, the court determines if it is necessary to compel a debtor to restructure its business. Thereafter, the involvement of the court is minimum. In the United States they created bankruptcy courts adjudicated by expert judges, whereas, in the UK and Kenya, they do not have special courts separate from the common law courts, but they have divisions within their courts that deal with business rescue and insolvency. Each approach has its own merits, and implementing them depends on the availability of resources. If South Africa decides to establish specialised courts, it is important to determine the jurisdiction of these courts in relation to the criminal matters that may emanate from business rescue. The role of the court is clear. It intervenes to protect the minority creditors, especially when the procedure allows a cramdown of creditors. The court preserves the integrity of the moratorium by ensuring that any application for leave to commence legal proceedings is fair. In some instances, the court is called upon to adjudicate criminal matters, for instance, where the debtor manages its business fraudulently. Basically, the court oversees that the parties comply with the enabling legislation, ensures that the rights of dissenting creditors are protected and that the debtor in financial distress is rehabilitated. The next chapter, which is the last chapter, embodies the conclusion and offers a proposal for the rescue of UBE.

Chapter 5 CONCLUSION, RECOMMENDATIONS AND FRAMEWORK

5.1 INTRODUCTION

In Chapter 1, it was stated that the main objective of the research was to determine the key characteristics of a business rescue model that would facilitate the rehabilitation of UBEs in South Africa. This chapter is divided into two main parts. The first part shows how each of the research questions posed in section 1.3 were answered. Based on my findings, I make recommendations for drafting the key characteristics of a business rescue model. The second part is a discussion of the significance of the study and its limitations. The chapter concludes with recommendations for further studies and concluding remarks.

5.2 Research question 1: The eligibility criteria

Chapter 2 aimed at answering the first research question: *How should debtors be classified to qualify for business rescue*? The study showed that an eligibility criterion should provide for four aspects, (i) business rescue should be restricted to business debtors only; (ii) the debtor must have the capacity to raise post-commencement finances; (iii) the debtor must not have been found guilty of any financial crime or fraud, and the (iv) debtor must be recognised as a legal person for the purposes of business rescue. These aspects are discussed in the following subsections.

5.2.1.1 Only business debtors should be allowed to apply for business rescue

The study shows that the business rescue process should be restricted to business debtors to ensure they remain economically active if they face financial difficulties. In turn, the procedure could increase creditor returns and prevent job losses. It appears that business rescue upsurges the debtor's willingness to be innovative and even engage in more entrepreneurial activities. Entrepreneurs are more inclined to pursue business ventures if there is a system to cushion their losses (see section 1.4.2) Business debtors contribute to the gross domestic product of an economy and the country's competitiveness in foreign markets; hence their failures should be mitigated by the business rescue process. A fully involved citizenry is critical to achieving optimum competitiveness with other countries. Most importantly, the study evinces

that sole proprietorships and partnerships are business debtors who must be considered for business rescue.[397]

The study shows that in determining whether a debtor is a business debtor, it is important to address four factors. The first factor is that it must be shown that the debtor has a place of business. This may be an office space or premises. At least the debtor should put in place proper booking-keeping systems. This requirement is derived from the USA and Kenya. According to the *Bankruptcy Code*, a sole proprietorship or partnership are eligible to apply for business reorganisation if the debtor's property or place of business is within America (see section 2.2.2.1). In Kenya, a debtor can apply for business rescue proceedings only if the debtor resides or has been carrying on business in the country for three years (see section 2.2.4.2).

The second factor is that debtor must be permanently engaged in commercial activities. In other words, the debtor's livelihood must depend on the going concern. In the USA, the debtor must be an individual conducting business as a sole proprietorship (see section 2.2.2.3). The UNICITRAL Legislative Guide 2005 recommends that regular engagement in the business indicates that the debtor is a business debtor (see section 2.3.1).[398]

The third factor is that the debtor must demonstrate that the business has employees or has the capacity to create employment. According to the InSOL Report, in circumstances where the business is identifiable with the natural person who remains liable for the business's debts, such a debtor should be treated as a consumer debtor.[399] However, in cases where the debtor's business has employees, such a situation may require different approaches to rehabilitate the business (see section 2.3.1.3).

Lastly, the debtor should provide a comprehensive inventory of the property used to conduct business. The *UNICITRAL Legislative Guide* 2005 recommends that when

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397 See (USA) *Bankruptcy Code:* sec. 109(d) read with sec. 101(41); (UK) *Insolvency Act* 1986: Part 8; (Kenya) *Insolvency Act* 2015: sec. 1 read with sec. 2.

398 See UNICITRAL 2005:39 par. 4.

399 See InSOL Report 2011:19-20.

dealing with sole proprietorships and partnerships, it is necessary to provide tests that determine whether they should be treated as consumer or business debtors.[400] These tests may include evaluating the value of the debtor's assets and liabilities (see section 2.3.1). A partnership by estoppel is excluded from applying business rescue because the partnership business is not meant to continue operating, whereas business rescue proceedings are meant for businesses that are intended to enjoy perpetual existence. (see section 2.2.2) It is recommended that the legislature may promulgate the eligibility provisions as exemplified below in recommendation 1.

Recommendation 1.1 : Eligibility requirements for a sole proprietorship and a partnership

(1) A debtor, whether sole proprietor or partnership and subject to the provisions of subsection (b) and (c) are eligible to apply for business rescue under this chapter, provided that the debtor –
- *(a) has a registered place of business;*
- *(b) is involved in the business permanently;*
- *(c) has the capacity to employ workers; and*
- *(d) has a comprehensive inventory of its business assets.*

(2) A partnership is eligible to apply for business rescue under this chapter if it is –
- *(a) an insolvent partnership; or*
- *(b) a partnership in dissolution.*

(3) A partnership by estoppel is not eligible to apply for the business rescue process.

5.2.1.2 Debtors should demonstrate that they have the capacity to raise post-commencement finances

Debtors should provide evidence that they can finance the business rescue process or acquire more capital to refinance their business to be eligible for business rescue. Since the debtor is personally liable for the debts and liabilities of the business, creditors bear a high risk of loss if the rescue fails. Therefore, the debtors, in their personal capacity, must be the interim financiers of the business rescue. For instance, the legislature can make it mandatory for the partners to contribute towards the business rescue. Besides, if debtors voluntarily forfeit their interests or salaries, creditors can interpret this as an act of good faith (see section 2.3.2).

Under the Chapter 6 business rescue scheme in South Africa, a debtor may demonstrate its capacity to finance business rescue by providing a bank guarantee

400 See UNICITRAL 2005: 39 par 4.

(see section 2.2.1.2). Under the US *Bankruptcy Code* Chapter 13, the debtor must provide evidence that they have a source of income, either as disposable income from receiving a salary or friends or family or inheritance(see section 2.2.2.3) However, in Kenya, where the debtor does not possess realisable assets, it may apply for the no asset procedure. This approach ensures that all debtors regardless of their financial status have access to the business rescue process (see section 2.2.4.3). Hence, it is recommended that the legislature draft this requirement as formulated below, nonetheless, the recommendation is not derived from any jurisdiction.

Recommendation 1.2 : Capacity to raise finance

(4) A debtor contemplated in subsections (1) and (2) must have the capacity to raise post-commencement finances. The debtor may prove this requirement by providing one or more of the following:

- *(a) a promisory letter from the bank;*
- *(b) a pledge from family member or friend;*
- *(c) a Will indicating that the debtor is entitled to a valuable asset or substantial amount of money;*
- *(d) a titled deed of an unencumbered property;*
- *(e) bank statement indicating disposable income; and/or*
- *(f) any financial agreement that shows that the debtor will be able to finance the business rescue process.*

5.2.1.3 Business rescue should only be confined to honest debtors

The study reveals that business rescue should be restricted to honest debtors, and fraudulent debtors should be relegated to liquidation proceedings. Business rescue is founded on the idea that calculated risk should be taken to save a financially ailing business. Therefore, taking such a risk is unnecessary if the business owner is fraudulent. Fraudulent debtors may abuse the business rescue process and effectively disenfranchise creditors. The legislature may exclude any debtors who have been convicted of financial crimes, including fraud (see section 2.3.3). Furthermore, if creditors suspect that the debtor might have committed fraud, such allegations must be investigated before the debtor is admitted to business rescue (see section 2.3.3). In South Africa, the courts have ruled that business rescue is not available to debtors involved in unlawful activities (see section 2.2.1.2). In the UK, courts have the authority to issue an order restricting a debtor from applying debt relief orders if it is shown that its application is in bad faith or the debtor has been convicted of any financial crimes

including fraud and theft (see section 2.3.3). Hence, it is recommended that the legislature draft this requirement as formulated in the US Chapter 13:

Recommendation 1.3: Honest debtor or good faith requirement

(5) An application for business rescue must be made by an honest debtor and in good faith.

(a) The debtor must –

(i) disclose all material facts to the business rescue practitioner or relevant official;

(ii) not have been convicted of any fraud or theft or any financial related crime.

(b) A debtor whose business includes unlawful activities is not eligible for business rescue.

(c) On application by any affected person, the court may issue an order requesting the business rescue practitioner to investigate the affairs of the debtor before admitting the debtor to the business rescue process.

5.2.1.4 Unincorporated business entities should be regarded as legal persons for the purposes of business rescue

The study suggests that sole proprietorships and partnerships should be recognised as legal persons for the purposes of business rescue. This aspect does not form part of the eligibility criterion, but serves to introduce a classification of debtors that is compatible to business rescue. UBEs should be recognised as legal persons to enable the business rescue practitioner to evaluate whether the UBE is viable for business rescue. It should be borne in mind that the disadvantage of UBEs is that they have unlimited liability. The owners or partners are personally liable for the debts and liabilities of the business. Therefore, when calculating the prospects of success, it is necessary to separate the personal debts of the entrepreneur from the debts of the business. This can best be achieved by recognising sole proprietorships and partnerships legal personality for purposes of business rescue.

This idea is not far-fetched from the current practices in South Africa. There are instances where a sole proprietorship is regarded as a legal person. In South Africa, the legislature in some instances recognises a sole proprietorship as a business entity. For instance, the *National Small Business Act* of 1996 recognises a sole proprietorship as a business entity for purposes of promoting entrepreneurship. Furthermore, the Uniform Rules of Court 2009 permits a sole proprietorship to sue or be sued in its own name (see section 2.2.1.4). A sole proprietorship is also required to file tax returns

together with the owners returns in terms of the section 8 of the *Income Tax Act* of 1962 (see section 2.2.1.4).

There are also numerous examples where the South African legislature recognises partnerships as legal persons. For instance, during legal proceedings partnerships can sue or be sued in their own names in terms of the *Uniform Court Rules* 2009. The *Consumer Protection Act* 2008 defines a juristic person as including a partnership for purposes of regulating business transactions involving consumers. Most importantly, partnerships are already recognised as legal persons for purposes of insolvency under the *Insolvency Act* 1936 (see section 2.2.1.5). In the UK, the *Insolvent Partnership Order* 1994 recognises partnerships as unregistered companies for the purposes of partnership administration or partnership voluntary arrangements (see section 2.2.3.3). Furthermore, in the USA, partnerships are recognised as legal persons for purposes of Chapter 11 business reorganisation (see section 2.2.2.1). This strongly suggests that UBEs may be recognised as legal persons for the purposes of business rescue.

If the legislature should decide to classify sole proprietors and partnerships as legal persons, it would imply modifying Chapter 6 to accommodate unincorporated entities (see section 2.3.4). The same approach was taken by the legislature in the UK when it modified provisions on company administration and promulgated the *Insolvent Partnerships Order* 1994 (see section 2.2.3.3). However, as demonstrated throughout the study, including UBEs to the already existing business rescue scheme attracts a variety of challenges. Hence, if the legislature decides to treat UBEs as legal persons, it should consider promulgating specialised business rescue processes,[401] (see 2.2.2 and 2.2.3). It is recommended the legislature may draft the provisions on legal personality as drafted in Chapter 11 of the *Bankruptcy Code*:

Recommendation 1.4: Legal personality

(6) If a sole proprietor or partnership is admitted to business rescue proceedings, its business is regarded as a separate legal entity for the purposes of business rescuing.

[401] For instance, the Chapter 13 business reorganisation process in the United States or the partnership administration order procedure in the United Kingdom.

5.2.2 Research question 2: The business rescue process

In Chapter 3, the study addressed the second research question*: What are the essential features of the business rescue processes of the selected jurisdictions*?

The study revealed that an efficient business rescue process must consist of (i) an accessible commencement procedure, (ii) a clearly defined moratorium, (iii) a comprehensive business plan, (iii) a solid post-commencement financing strategy, and (iv) most importantly, an exit strategy. These five features, as described below, are indispensable to the success of the proposed business rescue process for sole proprietorships and partnerships.

5.2.2.1 Commencement procedure

A commencement procedure should allow the debtor or its creditors to apply for business rescue. However, measures must be put in place to safeguard entry to the procedure. It is suggested that the legislature should consider the commencement procedure provided in sections 129 and 131 of the *Companies Act* of 2008 in South Africa (see section 3.2.1). Nonetheless, the provisions should not be adopted in its current state, modifications are necessary to accommodate the needs of sole proprietorships and partnerships.

The Act provides two ways to commence business rescue: voluntary commencement and involuntary commencement.

Voluntary commencement allows a debtor to commence business rescue. The study showed that sole proprietorships and partnerships may commence the voluntary commencement procedure.[402] If the debtor is a sole proprietorship, the owner of the business may commence business rescue. A debtor should be required to attend debt counselling before filing an application for business reorganisation (see section 3.2.1; 3.3.1.1 and section 3.3.2.1). The credit briefing must detail the opportunities for available credit counselling and how to do a budget analysis. Credit briefing is meant to educate debtors to avoid insolvency and manage their businesses on a solvent basis. The application for business rescue may be facilitated by an online portal accessed via a third party. The third part assists the debtor by identifying the required

[402] (USA) *Bankruptcy Code* 1978:sec. 301 (a); (UK). *Insolvency Act* 1986:sec. 251U(1)-(2); Kenya (*Insolvency Act* 2015: subdivision 2, secs. 316-320.)

information and documentation and then completes the online application with the debtor. The online platform is successfully implemented in the UK and Kenya. In the UK, a sole proprietorship may apply online for debt relief orders in terms of the *Insolvency Act* of 1986 (see section 3.4.1).In Kenya, a debtor may apply online for individual voluntary arrangement or summary instalment orders (see section 2.2.4).

With regards to partnerships, it is recommended that the legislature must emulate the approach taken by the USA *Bankruptcy Rules* 2015 rule 1004(a) of the *Bankruptcy Code* (see section 3.3.2.1). Rule 1004 provides that if the debtor is a partnership, all partners must agree to the voluntary commencement of business reorganisation. If one of the partners objects to the application for business reorganisation, the petition can continue as a compulsory business rescue application by the objecting partner. As a general rule, a partnership in financial distress is eligible to apply for voluntary business rescue (see section 3.3.2.1). However, the applicant must demonstrate that the business rescue process is meant to either save the business or provide a better return for the creditors. This goal is properly emphasised under the UK partnerships administration procedures outlined in schedule 2 of the *Insolvent Partnership Order* 1994 (see section 3.4.3.1). This suggests that business rescue for sole proprietorships or partnerships may be achieved through mergers, acquisitions or incorporations. The emphasis is not on the business structure but the going concern and its value for creditors (see section 3.3.2.1).

The second approach is involuntary or compulsory business rescue. This approach allows any affected person to apply for business rescue on behalf of the business. With regard to sole proprietorships, it is recommended that creditors should not commence an involuntary business rescue because it may amount to peonage. This practice has been classified as a form of slavery or forced labour in the United States, and Congress decided not to include any provisions for compulsory business reorganisation for Chapter 13 regarding a sole proprietorship (see section 3.3.1.1). For this reason, compelling a sole proprietor to commence business rescue for the benefit of creditors may not be welcome in South Africa. It is recommended that if sole proprietorships are to be subjected to compulsory business rescue, the applicant must obtain the debtor’s consent (see section 3.3.1.1).

Regarding partnerships, a partner who has failed to secure a majority vote for the business reorganisation may apply for compulsory business rescue alone or with the support of creditors. An affected person, besides a partner, may also apply for compulsory business rescue against a partnership if the partnership has not applied for business rescue or commenced liquidation proceedings (see section 3.3.2.1). The legislature may modify sections 129 and 131 of the *Companies Act* 2008, as illustrated below.

Recommendation 2:
Voluntary commencement procedure for sole proprietorships

(1) A debtor contemplated in Recommendation (1.1) may resolve that the business voluntarily begins business rescue and place it under supervision if the debtor has reasonable ground to believe that–
(a) the business is financially distressed; and
(b) there appears to be reasonable prospects of rescuing the business.

(2) A resolution contemplated in subsection (1) –
(a) may not be adopted if sequestration proceedings have been commenced against the debtor in terms of the Insolvency Act 24 of 1936;
(b) may not be adopted if the debtor has applied for debt review in terms of Chapter 4, part D, of the National Credit Act 34 of 2005; and
(c) has no force or effect until it has been filed.

(3) A resolution contemplated in subsection (1) must be filed with the Agency in the area where the debtor resides or conducts business. The resolution must be accompanied by –
(a) a nomination of a business rescue practitioner and a written acceptance of such nomination by the practitioner.
(b) a pre-assessment report of the business rescue practitioner indicating whether, in the opinion of the business rescue practitioner, –
(i) the debtor is in financial distress; and
(ii) there appears to be reasonable prospects of rescuing the business.

(4) The qualifying debtor in subsections (a) to (c) must cause notice to be served on all known creditors and affected persons, including SARS and any local Credit Bureau.

(5) A resolution commencing business rescue envisioned in subsection (1) may not be interpreted as an act of insolvency as contemplated in terms of section 8 of the Insolvency Act of 1936.

Recommendation 3: Objections to a business rescue resolution

(1) At any time after filing the business rescue resolution and until the confirmation of the business rescue plan, any affected person may apply to the court for an order setting aside–
(a) the resolution, on the grounds that the debtor–
(i) is an unrehabilitated insolvent;
(ii) is incapacitated due to insanity, ill health or death;

(iii) has been charged with and convicted of financial crimes;
(iv) the debtor's business is not in financial distress; or
(iii) the debtor's business has no prospects of being rescued;

(b) the appointment of the business rescue practitioner on the ground that–
(i) the practitioner lacks the necessary skills to oversee the rescue of the debtor's business;
(ii) is not independent of the business and the debtor; or
(iii) does not satisfy the requirement stipulated in section 138 of the Companies Act 71 of 2008.

(2) When considering an application in terms of subsection (1) to set aside the resolution commencing business rescue, the court may–
(a) set aside the resolution on any ground set in section 1(a); or
(b) afford the practitioner sufficient time to form an opinion whether or not
(i) the business appears to be in financial distress; and/or
(ii) there is a reasonable prospect of rescuing the business.

(3) After receiving a report from the practitioner in terms of section 2(b), the court may set aside the resolution or may make any further necessary and appropriate order.

Recommendation 4: Voluntary business rescue for partnerships

(1) A partnership in financial distress may resolve place the partnership under business rescue,if the majority of partners in terms of their voting rights in good faith and reasonably believe that–
(a) the partnership is financially distressed; and
(b) there appears to be a reasonable prospect of rescuing the partnership.

(2) A resolution contemplated in subsection (1)–
(a) may only be adopted if all partners give consent in writing;
(b) may not be adopted if winding up proceedings have been commenced against the partnership, and
(c) has no force and effect until it has been filed with the Agency.

(3) Within five business days after a partnership has adopted and filed a resolution, as contemplated in subsection (1), or such longer time as the Agency, on application by the partnership, may allow, the partnership must–
(a) publish a notice of the resolution, and its effective date, in the prescribed manner to every affected person, including with the notice a sworn statement of the facts relevant to the grounds on which the board resolution was founded; and
(b) appoint a business rescue practitioner who satisfies the requirements of section 138 of the Companies Act of 2008 and who has consented in writing to accept the appointment.

Recommendation 5: Objections to the adoption of a resolution

(1) At any time after the adoption of a resolution and until the adoption of a business rescue plan, an affected person may apply to a court for an order–
(a) setting aside the resolution because–

(i) there is no reasonable basis for believing that the partnership is financially distressed;
(ii) there is no reasonable prospect for rescuing the partnership; or
(iii) the partnership has failed to satisfy procedural requirements.

(b) setting aside the appointment of the practitioner on the grounds that the practitioner–
(i) does not satisfy the requirements of section 138 in the Companies Act of 2008;
(ii) is not independent of the partnership or its management; or
(iii) lacks the necessary skills, having regard to the partnership's circumstances; or

(c) requiring the practitioner to provide security in an amount and on terms and conditions that the court considers necessary to secure the interests of the partnership and any affected persons.

(2) When considering an application in terms of subsection (1)(a) to set aside the partnership's resolution, the court may set aside the resolution–

(a) on any grounds set out in subsection (1); or
(b) if, having regard to all of the evidence, the court considers that it is otherwise just and equitable to do so; or

(3) The court may afford the practitioner sufficient time to form an opinion whether or not
(i) the business appears to be in financial distress; and/or
(ii) there is a reasonable prospect of rescuing the business.

Recommendation 6: Involuntary business rescue

(1) A partner, or and an affected person may apply to a court at any time for an order placing the partnership under supervision and commencing business rescue proceedings.

(2) An applicant in terms of subsection (1) must–
(a) serve a copy of the application on the partnership and the Agency; and
(b) notify each affected person of the application in the prescribed manner.
(c) nominate a business rescue practitioner.

(3) Each affected person has a right to participate in the hearing of an application in terms of this section.

(4) After considering an application in terms of subsection (1), the court may–

(a) make an order placing the partnership under business rescue proceedings, if the court is satisfied that–
(i) the partnership is financially distressed;
(ii) the partnership has failed to pay over any amount in terms of an obligation under or in terms of a public regulation, or contract, with respect to employment-related matters; or
(iii) it is otherwise just and equitable to do so for financial reasons, and there is a reasonable prospect for rescuing the partnership; or

(b) dismiss the application, together with any further necessary and appropriate order, including an order placing the partnership under liquidation.

5.2.2.2 Moratorium on proceedings

The comparative assessment reveals that a business rescue should have a moratorium that has a well-defined scope (see section 3.2.2; section 3.3.1.2; section 3.3.2.2; section 3.4.1.2; and section 3.5.2.2) A moratorium protects the business from legal proceedings that may be brought against the debtor and frustrate the rescue process. The moratorium also guarantees equal treatment of creditors since they cannot all enforce their different rights against the debtor (see section 3.2.2).

The legislature may modify the moratorium in section 133 of the *Companies Act* 2008, since it has the same desired effect of staying all proceedings while the business is being rescued (see section 3.2.2). However, it was designed specifically for companies and cannot protect UBEs during the business rescue process. Sole proprietorships and partnerships are unincorporated entities, and the liability of the business is also the liability of the owner or partners. This statement implies that if sole proprietorships and partnerships are placed under the Chapter 6 business rescue procedure, creditors may still commence legal proceedings against the owners and partners in their personal capacities. Hence, the moratorium during business rescue must be designed to preserve the business and also protect the debtor (see section 3.2.2).

Chapter 13 of the *Bankruptcy Code* provides a valuable lessons for the legislature when dealing with sole proprietorships (see section 3.3.1.2). In terms of section 362 of the *Bankruptcy Code* a moratorium applicable to sole proprietorships must protect the owner's personal and business property.[403] Furthermore, the moratorium must protect codebtors, including spouses and guarantors. If creditors are allowed to pursue the owner of a sole proprietorship, the rescue process may fail because the owner may need the revenue generated by the business to defend the suit. In the same vein, if codebtors are subjected to legal proceedings, they may seek recourse from the assets of the business. The main reason for protecting the owners of sole proprietorships and their codebtors is that they are the main contributors to the success of the rescue process.

A partnership in business rescue also requires a moratorium that protects the business of the partnership. The legislature may follow the moratorium exemplified in article 6

[403] USA *Bankruptcy Code* 1978: sec. 362, Kenya *Insolvency Act* 2015:sec. 335(2).

para 43 of the *Insolvent Partnership Order* 1994 in the UK (see section 3.4.3.2). The UK approach suggests that a moratorium applicable to a partnership must include a stay of legal or repossession proceedings against the partnership, its property and the property in its possession. As a general rule, the partners are not covered by the moratorium. However, the moratorium provided by Chapter 11 of the *Bankruptcy Code* allows partners to apply for a temporal injunction (see section 3.3.2.2).[404] The partner seeking protection should demonstrate that if proceedings against his estate are allowed to continue, it may minimise the prospect of successfully rescuing the partnership. The court hearing the matter must weigh the interest of the creditors versus the partner's contribution towards the success of the rescue process.

To protect the interests of all interested parties, the legislature may incorporate the provisions in section 133 of the *Companies Act* 2008, which allows the creditor to approach the business rescue practitioner for consent or the court for leave to commence proceedings (see section 3.2.2). In other words, the business rescue procedure must also protect the interests of creditors by allowing the court to evaluate whether the moratorium is still serving its purpose.

The main aim of imposing a moratorium is to allow the debtor to prepare a business rescue plan and implement it without any distraction that reduces the likelihood of successfully rescuing the business (see section 3.2.2). At the same time, the system must ensure that creditors have a remedy for the protection of their rights (see section 3.2.2). It also appeared that the legislature must determine when the moratorium should begin and end.

The most convenient approach would be to make the moratorium automatic. This implies that the debtor does not need to apply for the moratorium to take effect. An automatic stay is time-effective and cost-efficient. It also comes to an end when the debtor has implemented its rescue plan or when the court converts the proceedings to liquidation proceedings (see section 3.2.2). It is thus recommended that the legislature should amend the moratorium provided by Chapter 6 and incorporate provisions applicable to sole proprietorships as provided Chapter 13 of the *Bankruptcy*

404 USA *Bankruptcy Code* 1978: sec.105.

Code (USA). The moratorium applicable to partnerships should follow article 6 of the *Insolvent Partnership Order* 1994 (UK), as demonstrated below:

Recommendation 7: Moratorium for sole proprietorships

(1) An application for business rescue, except with the business rescue practitioner's consent or leave of the court, automatically stays all legal proceedings against the debtor and the business including–

(a) liquidation proceedings or enforcement actions;
(b) any action to obtain possession of business property or to exercise control over property of the business;
(c) any action to create, perfect, or enforce any lien against the property of the business;
(d) the set-off of any debt owing to the debtor that arose before the commencement of business rescue.

(2) The filing of an application for business rescue does not operate as a stay against the commencement or continuation of criminal or civil proceedings–

(a) for the establishment of paternity;
(b) for the establishment or modification of an order for domestic support obligations;
(c) concerning child custody or visitation;
(d) for the dissolution of a marriage, except to the extent that such proceeding seeks to determine the division of property that is property of the estate;
(e) regarding domestic violence; or
(f) for the enforcement of medical expenses.

(3) Upon filing an application for business rescue, an affected party may not commence or continue any civil action, to collect all or any part of a consumer debt of the debtor from a codebtor unless–

(a) the business rescue plan filed by the debtor proposes not to pay such claim; or
(b) the continuation of such a stay would irreparably harm such creditor's interest.

Recommendation 8: Stay of proceedings for partnerships

(1) During business rescue proceedings, no legal proceeding, including enforcement action, against the partnership or in relation to any property belonging to the partnership or lawfully in its possession, may be commenced or proceeded within 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 partnership in any legal proceedings, irrespective whether those proceedings commenced before or after the business rescue proceedings began; or
(d) criminal proceedings against the partners.

(2) During business rescue proceedings, a guarantee or surety by a partnership in favour of any other person may not be enforced by any person against the partnership except with leave of the court, and in accordance with any terms the court considers just and equitable in the circumstances.

Recommendation 9: Temporal stay of proceedings against partners

(1) The court may issue a temporal moratorium against creditors from suing a partner or guarantors for the partnership debts on its own motion or on the request of an affected party.

(2) An applicant for a temporal stay of proceedings must demonstrate that–

(a) the debt relates to the partnership which has been admitted to business rescue, and

(b) if proceedings against the applicant continue, they may adversely affect the success of the business rescue process.

5.2.2.3 Business reorganisation plan

The business rescue plan provides different restructuring strategies that can be employed to rescue the debtor. There are many ways of rescuing sole proprietorships and partnerships in financial distress. The study showed that the legislature must attempt to balance the interests of creditors and the continuation of a business (see section 3.2.3).

It is proposed that there must be two preliminary inquiries before the creditors or the court considers a debtor's business rescue plan. This suggestion is based on US Chapter 11 and 13 of the *Bankruptcy Code* (see section 3.3.1.3 and section 3.3.2.3). The study shows that the plan must be proposed in good faith, and the debtor must have the means to finance the business rescue plan. The first inquiry is that the court should assess whether the debtor's proposed business reorganisation is not an abuse of the process (see section 3.3.1.3). The second inquiry is the means test (see section 3.3.1.3). The creditors or court must evaluate the debtor's business to ascertain if there is disposable or surplus income. Basically, the debtor should show that its business can generate income to pay its personal expenses, such as survival expenses and remains with a surplus. The surplus or disposable income should be sufficient to pay creditors for a determinable commitment period (see section 3.3.2.3).

The structure of a business plan should consist of the background to the business, a statement of proposals and assumptions or presumptions (see section 3.2.3). The background provides the business rescue practitioner with an overview of the debtor's

assets, creditors and financial situation. Whereas the statement of proposals is a list of different strategies that are meant to reorganise the business as a whole or provide a better return for creditors. The assumptions or presumptions are mainly projections on the success of the business rescue based on the proposals explained in the statement of proposals. This structure is captured correctly in section 150 CA 2008 and can be implemented by sole proprietorships and partnerships (see section 3.2.3).

The study focused mainly on the treatment of secured and unsecured creditors. Since Chapter 6 business rescue does not deal specifically with sole proprietorships and partnerships it is strongly advised that the legislature accept lessons from the Chapter 13 of *Bankruptcy Code* approach (see section 3.3.1.3). The study shows that there are three options for restructuring secured claims when drafting a business rescue plan. The first option is for a debtor to negotiate with a secured creditor about its secured claim. In this regard, the debtor may propose restructuring the secured claim, and the success of the negotiations is determined by whether the secured creditor agrees or rejects the proposal. The second option is for the debtor to surrender the encumbered property to the secured creditor. If the debtor still has possession of the encumbered property, it may propose surrendering the property and not paying the secured creditor's interest. The third and final option is to apply for a cramdown. If the debtor proposes modifying the credit agreement, but the debtor refuses, the debtor may apply for a cramdown. If the court is satisfied that a secured creditor's cramdown meets three criteria, it may issue an order confirming the business plan. First, the plan must provide for the creditor to retain its lien until the first payment is made on the debt. Second, the value of the property to be distributed under the plan cannot be less than the amount the creditor would receive if the debtor was placed in liquidation. Third, the plan must propose that the secured claim be paid within a specific time frame. It is recommended that the plan should not exceed five years (see section 3.3.1.3).

There are two ways of treating unsecured claims. The business rescue practitioner may modify the creditor's rights or negotiate for a partial or complete debt write-off. The modification of the creditor's rights gives the debtor a variety of options when dealing with unsecured creditors. This approach is dealt with extensively in the recommendations sections. Nonetheless, there are certain features unique to partnerships worthy of mentioning. First, the study showed that the partners remain

liable for the debts and liabilities of the partnership. The reorganisation plan can only be confirmed if the creditors accept the plan or if the non-consenting creditors will receive more than they would receive if the debtor were liquidated. Second, former partners seeking repayment or indemnification from the partnership may be classified as unsecured creditors. Furthermore, a business reorganisation plan can modify the partnership agreement, but the partners should approve such modification (see section 3.3.2.3).

The business rescue practitioner may propose the disposal of one of the partnership's assets or PVA, or liquidation of the partnership estate. This approach is taken from the UK section 14(3) CA 2006 and provides the legislature with further details on when and how should such disposal be made. Basically, creditors can accept the sale of the partnership property if the disposal is necessary to the survival of the partnership. The partners of an insolvent partnership may propose a composition to the partnership creditors in satisfaction of the debts and liabilities of the partnership. If the creditors agree to the composition, it implies that the partnership is commencing a different rescue scheme but with the support and consent of the creditors. Last, if the business rescue practitioner is of the view that it may not be possible to reorganise the partnership business, he may make recommendations for the liquidation of the partnership (see section 3.4.3.3). Generally, a business rescue plan for sole proprietorships and partnerships should provide schemes aimed at rescuing the business as a going concern and restructuring strategies aimed at specific debts. hence it is recommended that the legislature modifies section 150 of the CA 2008 and include provisions from 506 section of Chapter 13 *Bankruptcy Code* as follows:

Recommendation 10. Statement of proposals for business rescue

(1) The practitioner, after consulting the creditors, affected persons, and the debtor , must prepare a statement of proposals for consideration and possible adoption at the creditors' meeting.

(2) The statement of proposals must contain all the information reasonably required to facilitate affected persons in deciding whether or not to accept or reject the plan, and may be divided into three parts, as follows–

(a) ***Part A – Background****, which must include at least–*

(i) a verified statement of the affairs of the debtor;

(ii) a list of the particulars of the debtor property, debts and liabilities;

(ii) a list of the names and addresses of the creditors of the debtor;

(iv) *a list specifying the security held by each creditor;*
(v) *if the debtor is a partnership each partner's contribution and an indication as to whether it has been satisfied;*
(vii) *each partner's debts to the partnership and the payment plan;*
(iv) *the probable dividend that would be received by creditors, in their specific classes, should the debtor be placed in liquidation;*
(v) *a copy of the written agreement concerning the practitioner's remuneration; and*
(vi) *a statement of whether the business rescue plan includes a proposal made informally by a creditor of the partnership or a partner.*

(b) ***Part B – Proposals****, which must include at least–*
(i) *the nature and duration of any moratorium for which the business rescue plan makes provision;*
(ii) *the extent to which the debtor is to be released from the payment of its debts, and the extent to which partners or owner remain liable to pay the debts of the business;*
(iii) *the ongoing role of the debtor, and the treatment of any existing agreements; and any possible agreements that may alter the partnership agreement and, including–*
(aa) partnership voluntary agreement;
(bb) merger agreements;
(cc) acquisition of the business or parts of the business; and
(dd) incorporation of the partnership into a new company;
(iv) *the property of the debtor that is to be available to pay creditors' claims in terms of the business rescue plan; and any property pledged by the partners in their personal capacity;*
(v) *the order of preference in which the proceeds of the property will be applied to pay creditors if the business rescue plan is adopted;*
(vi) *If the debtor is a partnership the treatment of the partner's claims;*
(vii) *the continued liability of partners or owner; and*
(vii) *the benefits of adopting the business rescue plan as opposed to the benefits that creditors would receive if the partnership were to be placed in liquidation.*

(c) ***Part C – Assumptions and conditions,*** *which must include at least–*

(1) *a statement of the conditions that must be satisfied, if any, for the business rescue plan to–*
(aa) come into operation; and
(bb) be fully implemented;
(2) *the effect, if any, that the business rescue plan contemplates on the number of employees, and their terms and conditions of employment;*
(3) *the circumstances in which the business rescue plan will end; and*
(4) *a projected–*
(aa) balance sheet for the debtor; and
(bb) statement of income and expenses for the ensuing three years, prepared on the assumption that the proposed business plan is adopted.

(5) *A proposed business rescue plan must conclude with a certificate by the practitioner stating that any–*

(a) actual information provided appears to be accurate, complete, and up to date; and
(b) projections provided are estimates made in good faith on the basis of factual information and assumptions as set out in the statement.

Recommendation 11: Confirmation and adoption of the statement of proposals

(1) If the statement of proposals states that the business rescue practitioner reasonably believes that–
(a) the debtor has no sufficient property to enable each creditor of the partnership to be paid in full, or
(b) the debtor has insufficient property to enable a distribution to be made to unsecured creditors; he or she must file a notice to the Agency, the court and all affected persons and apply for termination of the business rescue proceedings.

(2) The business rescue practitioner must submit the statement of proposals to all creditors and partners of the partnership or owner of sole proprietorship–
(a) to organise two separate meetings for creditors and partners partnership; and
(b) to report the outcome of each meeting to affected persons, partners, creditors and the court.

(3) If the decision taken by the debtor's creditors differs from that taken by the meeting of the partners or owners, the debtor may apply to court for the approval of the statement of proposals.

(4) If the outcome in both meetings is in favour of the statement of proposals, the business rescue practitioner must submit the minutes of the meeting to the Agency and serve every affected person.

5.2.2.4 Post-commencement finance

The study revealed that debtors involved in business require further financing after commencing business rescue (see section 3.2.4). A debtor should secure finances to pay for operational expenses. The main problem in South Africa is that sole proprietorships and partnerships are undercapitalised (see section 2.3.2). Therefore, it may not be easy to secure post-commencement finance. However, section 135 CA 2008 provides an ideal approach to post-commencement financing. A creditor who extends credit to a debtor in financial distress obtains preferential rights. This approach ensures that post-commencement creditors enjoy preferential treatment if the business rescue succeeds or fails (see section 3.2.4).

The study showed that a debtor in financial distress is allowed to request further financing. However, the legislature may require the owner of a sole proprietorship or partners of a partnership to be the first contributors or financiers of the business rescue

process. In fact, in the USA, the trustee who acts as a business rescue practitioner has the duty to claim contributions due to the partnership (see section 3.3.2.3). The business rescue practitioner may also sell the property of the business to raise funds. If the property belongs to a sole proprietor married in community of property, the spouse's consent is required. If the property belongs to the partnership, all the partners must consent to sell the property. Although the debtor is allowed to apply for further credit, the legislature in Kenya imposed a limit on such financing (see section 3.5.2.4).[405] In South Africa, the legislature may provide that the relevant minister may determine how much a debtor in business rescue may borrow. This approach will prevent reckless trading, over-indebtedness and abuse of process. The recommendation follows section 135 of CA 2008 and section 342 the IA 2015 Kenya. Thus for purposes of financing business rescue, the legislature may adopt the following recommendation.

Recommendation 12: Post-commencement finance

(1) The statement of proposals may contain provisions for the funding of the business during the business rescue process and may recognise preferent rights to post-commencement creditors.

(2) During the period between the commencement of the business rescue process and the approval of the plan–

(a) unencumbered assets may be used to meet expenses in the ordinary course of business, as may be necessary to maintain the business as a going concern; provided the creditor who holds the security rights consents in writing to the use of the asset or assets; and

(b) any person may provide funding, including the individual entrepreneur, employees, family and friends.

5.2.2.5 Discharge or exit strategy

The study validated the assumption that a business rescue procedure must provide the debtor with some form of discharge or exit plan (see section 3.2.5). Discharge in this sense means that the debtor is no longer held liable for the debts of the business and is allowed to start afresh.

The comparative assessment showed that a debtor in business rescue may exit the process by substantially implementing the plan or through a hardship discharge. Chapter 11 and 13 of the US *Bankruptcy Code* provide good discharge strategies for

405 Kenya *Insolvency Act* 2015:sec. 342(3).

sole proprietorships and partnerships. If the debtor is a sole proprietor, the debtor may be deemed to have substantially implemented its business rescue plan if all operation expenses are paid and survival or relational debts no longer affect the solvency of the business. In such a situation, the debtor is no longer liable for operational expenses but remains liable for survival debts or relational debts such as mortgage or maintenance. If the debtor is a partnership, the partnership debts must be paid in accordance with the business rescue plan. The effect of discharge is that the partnership will no longer be liable for the debts of the business, but partners continue to be liable for the debts and liabilities of the partnership (see section 3.3.2.4).

A hardship discharge occurs when the debtor fails to complete payments due to unforeseen circumstances beyond its control. The idea is that where debtors can no longer make payments because of economic recession or loss of property in a storm or fire, the insolvency system should not accelerate their downfall. Instead, it should provide a springboard to business recovery by freeing the debtor's estate from liability. The main problem faced by sole proprietorships is that they have business debts and personal debts. Therefore, the procedure may only permit the grant of a discharge if modification of the plan is not practicable and if unsecured creditors have received distributions under the plan that are not less than they would have received in liquidation proceedings (see section 3.3.2.4). The following recommendation is an adaptation of section 1329 of Chapter 13 and 1141 section Chapter 11 of the *Bankruptcy Code*.

Recommendation 13: Discharge for sole proprietorships

(1) As soon as practicable after completion by the debtor of all payments under the plan have been paid, the court has authority to grant the debtor a discharge of debts provided for by the plan except any debt for–

(a) restitution, or a criminal fine, included in a sentence on the debtor's conviction of a crime; or

(b) restitution, or damages, awarded in a civil action against the debtor as a result of wilful or malicious injury by the debtor that caused personal injury to an individual or the death of an individual.

(2) At any time after the confirmation of the plan, the court may grant a discharge to a debtor that has not completed payments under the plan only if–

(a) the debtor's failure to complete such payments is due to circumstances for which the debtor should not justly be held accountable; including natural disasters, war or any event that may render it impossible for the debtor to implement its plan;

(b) the value of the property distributed in terms of the plan on account of each allowed unsecured claim is not less than the amount that would have been paid on such claim if the estate of the debtor had been liquidated in terms of the Insolvency Act of 1936; and
(c) modification of the plan is not practicable.
(d) if the debtor is a sole proprietorship and the owner has died.

Recommendation 14: Implementations and discharge for partnerships

(1) After the adoption of the business rescue plan, the business rescue practitioner oversees the implementation of the business rescue plan.
(2) The business rescue process may be terminated if–
(a) the partnership fails to adopt a business rescue plan;
(b) the business has subsequently filed a notice of substantial implementation of that plan; or has filed an application winding up the partnership; or
(c) one of the partners has passed away.

5.2.3 Research question 3: Institutional structures

The third research question was: *What are the roles of the debtor, business rescue practitioner, and the judiciary in ensuring that unincorporated business entities are rehabilitated?* Chapter 4 of the study discussed the different role players and institutions responsible for the success of the business rescue process.

The study revealed that the efficiency of a business rescue process depends on the honesty and cooperation of the debtor, the diligence of the business rescue practitioner and the prudence of a specialised insolvency and business rescue judge. The following discussion provides the roles of each actor and institution in the rescue of UBEs.

5.2.3.1 Rights and duties of the debtor in business rescue

The debtor is one of the important players in business rescue. Most of the debtor's duties and responsibilities are prescribed by the legislature. However, the success of business rescue depends on the debtor's cooperation and willingness to keep the business afloat (see section 4.2.1).

Chapter 6 of the CA 2008 provides certain rights and responsibilities to the board of directors. Nonetheless, the study showed that the management of sole proprietorships and partnerships cannot assume these rights and duties without difficulties (see section 4.2.1). First, the board of directors is required to commence business rescue

timeously. If the board decides not to commence business rescue, it is required to notify all its creditors. The problem with this approach is that if a sole proprietorship or the management of a partnership informs its creditors that it is in financial distress but has decided not to commence business rescue, the creditors may commence compulsory sequestration. This is the main flow of Chapter 6 (see section 4.2.1)

Second, directors are required to cooperate with the by providing all the materials and support required to draft a business rescue plan. The issue with UBEs is that sole proprietors and partners may be sceptical about cooperating with the business rescue practitioner for fear of losing their business to an outsider. Some businesses are operated by families; hence cooperation may be difficult. These are some of the difficulties that business owners may face if Chapter 6 responsibilities are assumed without amendments (see section 4.2.1).

The study showed that when attempting to rescue sole proprietorships, it is recommended to adopt the USA Chapter 13 approach, which allows the debtor to remain in possession (see section 4.2.1.2). This approach implies that the debtors has the right and duty to continue managing the day-to-day affairs of the business. The reasoning behind this idea is that it gives the debtor a sense of control and may easily cooperate with the business rescue. Although the debtor remains in control of the business, it should manage the business to generate profit. If the debtor is managing the business at a loss, the court may terminate business rescue and commence liquidation proceedings. Hence, to keep the debtor on track, the law may require the debtor to open an account for the business, and the business rescue practitioner may inspect such an account from time to time (see section 4.2.1.2). This will enable the practitioner to assess whether the business is making a profit or failing. If it fails, the practitioner may advise the creditors to apply for the conversion of proceedings to liquidation proceedings.(4.3.1.1)

In addition to the above responsibilities, the debtor should submit periodical reports to the courts and the business rescue practitioner. The duty to report is meant to protect the creditors, especially if it is suspected that the business is failing rather than recovering. Nevertheless, the debtor has the right to negotiate for further financing. This right promotes entrepreneurialism in that although the debtor is in financial distress, it is important to allow the debtor to outsource funding. Although the debtor

has the authority to obtain post-commencement finance, the business rescue practitioner may monitor the conclusion of such new transactions (see section 4.3.1).

The rights and duties of a sole proprietorship are the same rights enjoyed by a partnership; however, certain rights unique to partnerships are worth mentioning. The management of the partnerships is allowed to continue managing the business of the partnership or surrender the business to the business rescue practitioner. The latter approach is exemplified by the UK partnership administration procedure (see section 4.4.2). It appears that if a partnership's management surrenders its business to a business rescue practitioner, the partners assume all of the rights and responsibilities of directors. The study indicated that in addition to the duties of the directors, all partners are required to contribute to the reorganisation of the partnership. Business reorganisation requires financing, and partners are jointly liable for the partnership; hence, their contribution is needed for the recovery of the business (see section 4.3.2). The legislative recommendation bellows follows the footsteps in Chapter 13 and article 6 of the IPO 1994.

Recommendation 15: Rights, duties and powers of a sole proprietor during business rescue

(1) A debtor in may continue to operate its own business subject to any limitations or conditions prescribed by the court.

(2) The debtor has the same rights and duties as a debtor in possession, including the duty to–

- *(a) operate its business in compliance with any applicable law;*
- *(b) open and maintain a new bank account in connection with the continued operation of the business; or*
- *(c) file periodic reports and summaries of the operation of its business, including a statement of receipts and disbursements with the court, the Agency and South African Revenue Services.*

(3) A debtor in business rescue is authorised to–

- *(a) obtain unsecured credit and incur unsecured debt in the ordinary course of business as an administrative expense;*
- *(b) appoint an attorney for purposes of litigation; and*
- *(c) use or lease or dispose of the property of the business in a manner that generates profit for the business.*

(4) A debtor under is required to cooperate with the business rescue practitioner. The debtor must–

- *(a) make available all the books of accounting;*
- *(b) surrender disposable income and any property for disbursement to affected persons; and*

(c) disclose any material information necessary for the practitioner to recommend business rescue and oppose liquidation proceedings.

Recommendation 16: Rights, duties and powers of partners during business rescue

(1) All partners have the same rights and obligations as directors in section 142 of the Companies Act 2008.

(2) In addition to the rights in subsection (1), partners have the power to–

(a) apply for the removal of the business rescue practitioner;
(b) participate in any legal proceedings related to the partnership;
(c) request a report on the progress of business rescue proceedings; and
(d) assist the business rescue practitioner.

(3) In addition to the rights and obligations in subsection (1), partners have the duty–

(a) to act in good faith;
(b) to contribute to the business rescue process;
(b) to continue to be liable for the debts and liabilities of partnerships;
(c) not to claim remuneration;
(d) not to compete with the business of the partnership; and
(e) not to assign their rights unless provided in the business rescue plan.

5.2.3.2 Rights and responsibilities of the business rescue practitioner

The study showed that the business rescue practitioner is an important figure in recovering any business in financial distress (see section 4.2.2). However, the role and function of the business rescue practitioner depend on the business rescue regime. In some jurisdictions the business rescue practitioner is appointed as an observer of the business rescue process, while in others, the practitioner takes over the management of the business (see section 4.3.4 and 4.4.2). It is not clear which approach best serves the interest of creditors and the debtor while successfully rescuing the business.

Under the CA 2008, the business rescue practitioner replaces the board of directors and manages the company throughout the rescue process. The practitioner's duties and responsibilities are clearly laid out in the CA 2008 (see section 4.2.2). From the study, it seems that these duties and responsibilities of the practitioner cannot be replicated if UBEs were admitted to the Chapter 6 business rescue (see section 4.2.2). Basically, investigating sole proprietorships and partners needs more regulation because it may involve the debtor's personal life and relationships. Although there may be challenges in duties by discharging certain duties, the study indicated that BRPs are qualified to draft and implement a business rescue plan for sole proprietorships and partnerships (see section 4.2.2).

In the USA, if a sole proprietorship is admitted to the business rescue process, the business rescue practitioner would monitor the debtor's activities (see section 4.3.4).The practitioner would assume the role of observer and advisor of the debtor. Generally, the practitioner does not replace the debtor but acts as the custodian of the estate of the business. In this position, the practitioner would have the following duties:

First, the practitioner should appear in court on behalf of a sole proprietorship's estate and advise the court on any matter that concerns the debtor (see section 4.3.4). The court may require the business rescue practitioner to provide a liquidation analysis to ascertain whether each creditor will receive more than it would if the debtor business is liquidated. Second, the business rescue practitioner has the authority to investigate the debtor's conduct and finances regarding matters concerning the business and personal life. More importantly, the business rescue practitioner should investigate whether the continuation of the business is in the best interests of the creditors. Third, the practitioner should ensure that the debtor pays its creditors. This means that it is the business rescue practitioner's responsibility to remind the debtor to make payments in accordance with the reorganisation plan. If the debtor fails to pay because the business rescue practitioner failed to follow up, the practitioner may be liable to all stakeholders, namely partners, employees and creditors. Fourth, the business rescue practitioner is required to account for all property and money received from the debtor for disbursement. In this regard, the practitioner has a duty to recover payments erroneously paid to creditors. Basically, the business rescue is appointed to preserve the debtor's estate by ensuring that the business is making profit. Furthermore, the practitioner should protect the interest of the creditors and ensure that they receive payments as promised in the reorganisation plan. Above all, the practitioner should provide the court with comprehensive and well-informed advice on the debtor's affairs (see section 4.3.2).

If the debtor is a partnership, it appears that the business rescue practitioner steps into the shoes of the management of the partnership as envisioned by article 6 of IPO 1994 UK (see section 4.4.2). Since the partnership is regarded as a juristic person during the rescue process, the practitioner is in a similar position as a business rescue practitioner in Chapter 6 business rescue. This also means that practitioners are protected under the business judgment rule in cases where they take reasonably calculated risks to rescue the business but it still fails (see section 4.4.2) In this

position, the business rescue practitioner may be required to manage the partnership's business for the benefit of all interested in the insolvent estate. The business rescue practitioner should collect and control the partnership property. This means that the partners must disclose to the practitioner any partnership property. The law may authorise the business rescue practitioner to transfer the entirety or a portion of the partnership business. If the statement of proposals contemplates selling the partnership property, the business rescue practitioner is authorised to do so and advise the creditors. The partnership may pursue its debtors for claims owed to the partnership, and the practitioner is allowed to appoint an attorney to litigate such claims. Most importantly, the BRP has the duty to negotiate for any form of arrangement that may result in the resuscitation of the partnership (see section 4.4.2).

It is recommended that in South Africa, the business rescue practitioner should only be appointed during the rescue of a UBE if the debtor's estate will not be overburdened. To ensure that the creditor's interests are protected, the debtor should be required to provide regular reports to the creditor's committee and the court. The duties of a business rescue practitioner assisting sole proprietorships must follow the example of the US Chapter 13 and the duties applicable to partnership should emulate the duties outlined in article 6 IPO 1994:

Recommendation 17: Duties of the business rescue practitioner during the rescue of sole proprietorships

A business rescue practitioner who accepts nomination by the debtor in terms of recommendation 5(3) or is nominated by an affected person in terms of section 13(2).

(1) must prepare an honest and fair pre-assessment report which must form part of the debtor's resolution to commence business rescue;

(2) must assist the debtor in preparing a statement of proposals;

(3) must receive disposable income from the debtor for redistribution to affected parties in terms of the approved plan;

(4) may investigate, the operation of the debtor's business and the desirability of the continuance of such business to investigate the financial affairs of the debtor;

(5) may examine proofs of claims and object to the allowance of any claim that is improper;

(6) may oppose the discharge of the debtor if it is in the best interest of creditors;

(7) must monitor the business of the debtor and regularly report to creditors on the progress of the debtor; and

(8) must make a final report and file a final account of the debtor's affairs with the court, each affected person and the Agency.

Recommendation 18: Rights and duties of the business rescue practitioner during the rescue of partnerships

(1) During a partnership's business rescue proceedings, the practitioner, in addition to any other powers and duties set out in this chapter–

(a) has full management control of the partnership business

(b) may delegate any power or function of the practitioner to a person who was part of the management of the partnership to be responsible to –

(i) develop a business rescue plan to be considered by affected persons; and

(ii) implement any business rescue plan that has been adopted.

(c) During business rescue, the business rescue practitioner acts as the agent of the partners of the partnership and has the authority to–

(i) transfer the whole or any part of the business and property of the partnership;

(ii) call up any uncalled capital of the partnership;

(iii) grant or accept a surrender of a lease or tenancy of any of the property of the partnership, and to take a lease or tenancy of any property required or convenient for the business of the partnership;

(iv) take possession of, collect and get in the property of the partnership;

(v) sell or otherwise dispose of the property of the partnership by public auction or private contract;

(vi) raise or borrow money and grant security therefore over the property of the partnership;

(vii) bring or defend any action or other legal proceedings in the name and on behalf of the partnership; and

(viii) effect and maintain insurances in respect of the business and property of the partnership.

(d) A person who deals with the business rescue practitioner in good faith and for value need not inquire whether the practitioner is acting within his powers.

(e) The business rescue practitioner is entitled to charge not more than seven per cent of the disposable income for the remuneration and expenses of the practitioner.

5.2.3.3 Possible functions of the Small Business Development Agency

It emerged through the study that it may be necessary to establish a state-regulated institution that oversees the rescue of debtors in financial distress. In the UK and Kenya, the legislature created the office of the official receiver (see sections 4.4.1 and section 4.5.1). The main objective of the official receiver is to control bankruptcy proceedings, whether liquidation or rescue, and conduct investigations related to insolvency or bankruptcy. Pertaining to the rescue of sole proprietorships and partnerships, the official receiver facilitates different rescue procedures. The main

advantage of the official receiver is that a debtor may be rescued without involving the court and the online portal system makes the procedure accessible cost and time effective (see section 4.4.1 and section 4.5.1). The study revealed that the effectiveness of a business rescue procedure may be guaranteed by a separate institution other than the court.

It may not be necessary to establish a new institution in South Africa but the legislature may extend the mandate of the already existing institution responsible for small business: SEDA. The extension may include facilitating business rescue for sole proprietorships and partnerships (see section 4.2.2.3). The immediate advantage of using an already existing institution is that SEDA already has existing business networks and receives government assistance that may assist debtors in resuscitating their businesses. Furthermore, SEDA is responsible for assisting start-up businesses and has implemented the incubation programme to assist early entrepreneurs in their first year of starting the business. Incubation has been shown to reduce the failure rate of small businesses during their first few years of operation. SEDA has the expertise and structures that may prove beneficial in restructuring debtors in financial distress. Lastly, SEDA already has infrastructure throughout the country. There are many branches accessible to urban and rural business owners in all nine provinces. For this reason, it may not be necessary for government to build or buy new properties to set up offices for business rescue (see section 4.2.2.3). It is therefore, recommended as follows:

Recommendation 19: Small Business Development Agency

(1) In addition to the function of the Agency stipulated in section 10 of the National Small Business Amendment Act, 2004, the Agency must–

(a) facilitate the business rescue proceedings applicable to sole proprietorships and partnerships;

(b) subsidise where practical the business rescue proceedings;

(c) facilitate business networking for purposes of rescuing the debtor;

(d) receive business rescue resolutions and serve creditors and all affected persons;

(e) appoint a commissioner to receive and act as liaison between the Agency, the debtor and affected persons;

(f) receive reports on the progress of business rescue and serve creditors and any affected persons; and

(g) refer matters to the relevant institution where business rescue has been terminated.

5.2.3.4 Role and function of the court

The study revealed that the business rescue process cannot be sustained without the involvement of the court. (see section 4.2.3; section 4.3.7 and section 4.4.3) The court's main functions are to safeguard access to the business rescue process, protect the interests of all creditors; preserve the integrity of the moratorium, and hear any procedural or criminal matters that may arise during the process.

The comparative study showed that the court is involved from the beginning of the rescue process. The law should allow any affected party to apply for an order compelling the debtor to commence business rescue. The court determines whether a debtor should be allowed to commence a business reorganisation. Furthermore, the court intervenes where parties to the rescue process have competing rights; for instance, minority creditors versus majority creditors. Since the court does not have any interest in the debtor, it is rightly positioned to give directives such as creditor cramdown. In all jurisdictions, it appears that the debtor is required to apply to the court for leave to commence legal proceedings. This exception places the court at the forefront of the rescue process because the progress or failure of the rescue process will depend on the court's decision. The court should be well equipped to predict and avoid any adverse consequences of granting leave to commence business or the prejudice that a creditor may suffer if leave is denied. Moreover, in some jurisdictions, where legislature criminalised certain conduct, the court can hear offences committed under such legislation (see section 4.3.7, 4.4.3, and 4.5.3).

The study suggests that it is important to establish specialised insolvency and business rescue court. In USA, the *Bankruptcy Code* establishes Bankruptcy Courts which has exclusive jurisdiction to hear matters pertaining to the rescue of sole proprietorship, partnerships and companies (see section 4.3.7). Although the UK and Kenya there are no specialised courts similar to the US approach, they have specialised divisions that deal with bankruptcy issues (see section 4.4.3 and section

4.5.3). Therefore it is recommended that South Africa should consider establishing specialised courts for the following reasons:

First, specialised courts will reduce caseload crisis in general courts. Business rescue is also regarded as a quick and short procedure. Hence, specialised courts will be better positioned to address any legal issue that requires the judiciary to decide. Second, specialised courts will increase the expertise in business rescue and insolvency. The more judges specialise, the more their decisions are prudent and accurate. With the rapid increase of new and innovative ideas of conducting business, it will become more and more complicated for general courts to decide issues arising from failing businesses. Third, in cases where courts specialise in a particular legal subject, the application and interpretation of the law tend to be uniform. In turn, the uniform interpretation of the law results in establishing the certainty of the law. These are the basic foundation principles of an efficient legal system. Based on these reasons, it is recommended that South Africa should consider establishing specialised courts. The legislature may consider the current Company Tribunal as the relevant court for business rescue and amend the provisions in section 195 of the CA 2008 to include the following:

Recommendation 20: Company tribunal

(1) In addition to the function stipulated in section 195 of the Companies Act of 2008, company tribunals may include–

(b) adjudicate and resolve any dispute in relation to this Act, including–

(i) an application for compulsory business rescue;

(ii) an application for the removal of a business rescue practitioner; and

(iii) an application for the termination of business rescue and the commencement of liquidation proceedings in terms of the Insolvency Act 1936.

5.3 VALUE OF THE STUDY

The research contributes to the legal theory of business rescue, specifically focusing on sole proprietors and partnerships in South Africa. It provides a theoretical framework for the different procedures that can be made available to debtors in financial distress. The study incorporates different business rescue procedures that

are implemented in the USA, UK, South Africa and Kenya. Hence the legislature in South Africa may derive valuable lessons from national and foreign practices in assisting business debtors in financial distress (see section 1.5).

The study is based on the proposition that a business rescue framework that oversees the rehabilitation of UBEs while considering the interest of all stakeholders would promote business efficacy and with time, may secure the confidence of local and international investors. Thus, the primary motivation of the study was the preservation of viable enterprises, regardless of their legal form, size or relevant sector. This approach is projected to increase creditor returns, enhance entrepreneurialism and improve the country's competitiveness internationally. With the surging inflation and high unemployment is important to put in place procedures that salvage small businesses (see section 1.4). The proposed framework although not perfect provides a starting point, the next part explores some of the limitations of the study.

5.4 LIMITATIONS OF THE STUDY

The study is subject to limitations. The first limitation is that there are very few studies on business rescue for sole proprietorships and partnerships in South Africa. Hence the study does not cover all aspects of business rescue such as the impact of business rescue on existing contracts, liability of silent partners, partners en commandite, and employee's rights. The study only dealt with ordinary partnerships further studies may include the implications of business rescue on specific types of partnerships. Furthermore, the available studies on the success of business rescue in the selected countries do not distinguish between salaried debtors and individuals involved in businesses as sole proprietorships. Hence, the conclusions provided apply to salaried debtors as much as they apply to sole proprietorships with very few exceptions.

Second, the study relied on information available online and some of the databases are not always updated. For instance, there are very few case reports on the Kenya database. In South Africa, the UK and Kenya, there is no specialised database for business rescue case law. Hence, the study might have left out important case laws.

Generally, when attempting to find an answer to a research topic through the use of doctrinal analysis, one opens oneself up to the risk of criticism. The law is a social endeavour. This reduces the level of assurance that can be reached. In other words, given the subjective nature of the law, it cannot be scientifically tested in the same way

as empirical hypotheses can. Hence, the conclusions and suggestions contained in this work are subject to different interpretations. Further studies may be required.

5.5 RECOMMENDATIONS FOR FURTHER STUDIES

Although the study was aimed at providing a model, the framework does not provide for all aspects of a legislative framework. Certain aspects of this study still require further study, namely issues such as the position of employees, the insolvency of partners or spouses, and harmonising the current legislation with the suggested legislation.

The study focused on procedures meant to rescue sole proprietorships and partnerships businesses to, among other goals, save jobs. Nonetheless, the study did not explore the rights and duties of employees employed by UBEs. Hence, further studies may explore the different approaches that may save small businesses and while promoting employee rights. The other area for further study is the involvement of partners and spouses during the rescue of sole proprietorships and partnerships. Life partners and spouses may have legal interests in the welfare of the businesses. The study did not explore their rights to commence business rescue, their rights during the operation of the moratorium and their consent for the acquisition of post-commencement finance. These and other issues need to be explored.

Lastly, sole proprietorships and partnerships are operated by individuals who are also subjects of different legislation. Further studies may explore the harmonisation of legislation such as the *Insolvency Act* 24 of 1936, the *Income Tax Act* 80 of 1961, *National Credit Act* 34 of 2005 and *Consumer Protection Act* 68 of 2008 towards assisting the rescue of natural persons involved in economic activities as sole proprietorships and partnerships.

5.6 CONCLUDING REMARKS

It is evident from the study that South Africa is lagging behind on its current policies and legislation relating to sole proprietorships and partnerships in financial distress. The available legislation fails to facilitate the rescue of UBEs in financial distress, yet these business entities are essential to the economy. Nonetheless, drafting a business rescue procedure for unincorporated business entities is difficult. The main difficulty arises from their close and complicated relationship with the owners or partners. The

other difficulty is that unincorporated business entities are under capitalised, hence in the future it will be necessary to draft a business rescue scheme specifically for no asset businesses. The UNICITRAL Legislative Guide 2005 has already recommended a no-asset procedure for companies emphasising that the scheme may be necessary to facilitate an exploratory investigation into the affairs of the debtor and promote entrepreneurial activities (see section 3.5.3).

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