International Corporate Rescue

ChaseCambria
SOUTH SQUARE
Centre for Commercial Law
UCL LAWS

Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

www.chasecambria.com

Annual Subscriptions:
Subscription prices 2013 (6 issues)
Print or electronic access:
EUR 695.00 / USD 845.00 / GBP 495.00
VAT will be charged on online subscriptions.
For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

ARTICLE

BRP Proceedings: Introducing a New Rescue Culture in South Africa

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In May 2011, Chapter 6 of the South African Companies Act, No. 71 of 2008 came into force, introducing a restructuring process into South African law: business rescue proceedings ('BRP'). The introduction of BRP constituted a significant change to the restructuring and insolvency landscape in South Africa, providing an alternative to the existing liquidation process aimed at allowing companies in financial difficult to restructure financially and operationally.

This article provides a brief introduction to the BRP process from the perspective of those involved in international restructurings. It identifies and highlights a number of features in the new legislation which will interest international investors involved in restructurings, or potential restructurings, in South Africa. The article also includes a practical example, a case study of how BRP works in practice.

Overview of the BRP process

BRP is a largely out-of-court restructuring process enabling a debtor in financial distress to restructure and reorganise its capital structure and business. A BRP practitioner ('BR Practitioner') is appointed who, under the protection of a court-supervised moratorium against creditor action, will take over the management of the debtor and prepare, negotiate and implement a 'business rescue plan' (the 'BR Plan'). The BR Plan needs to be approved by 75% of the creditors' voting interests (in value), including at least 50% of the independent creditors. Once approved, it will be binding on the debtor and all of its creditors. The BRP process should generally end within three months, but this can be extended by the court on an application by the BR Practitioner.

The objective is to maximise the chances of rescuing the business and for the company to continue to exist on a solvent basis and it is intended to be a commercial process, focusing on a negotiated solution agreed between the BR Practitioner and the affected creditors and other affected stakeholders of the company.

The South African BRP regime introduces a framework for creditors to initiate and lead successful restructurings to achieve results similar to those achieved in English and some European restructurings. However, BRP remains a largely untested process and many of the key BRP provisions have not been examined by the South African courts. As a result, it remains to be seen whether BRP will be utilised as the commercial restructuring option it has the potential to be.

Noteworthy features and issues

The BRP regime provides for a quick and flexible process and contains a set of useful provisions to achieve a financial restructuring of a distressed company. Some of the more noteworthy features and issues associated with the BRP regime are described below.

- *Creditor selection of BR Practitioner*. If a creditor applies for BRP, they have the ability to expressly nominate the individual they would like to see appointed as the BR Practitioner. The choice of individual to act as BR Practitioner can often be critical to the strategy pursued during BRP. Creditors will want to appoint an individual who they have confidence in and who they believe will protect their interests as far as possible. By contrast, in a liquidation process only the court has the power to choose the identity of the liquidator.
- *Broad scope*. The scope of a BRP plan is not prescribed and is consequently very flexible. It can, for example, include a debt for equity swap.
- *Cram down*. Once a plan is approved by the requisite majority of creditors, it will be binding on all creditors, including any dissenting hold-outs, thus providing an English style cram down. This cram down is enhanced, by comparison with the English at least, by two things. First, the court can overturn any 'no' vote on the grounds that it is 'inappropriate', and second, there is a buy out right in respect of dissenting voters (see below).

Notes

1 Case study provided by Lionel Shawe, Ulrike Naumann and Claire van Zuylen, Bowman Gilfillan, Johannesburg.

- *Buy-out right of interests of dissenting voters*. If a party voting on a proposed BR Plan rejects it, the claims of that party may be bought out by other stakeholders at liquidation value. The liquidation value is to be 'independently and expertly determined' which, in practice, raises valuation issues. This buy out right probably applies in respect of both dissenting shareholders and dissenting creditors, but the drafting of the legislation lacks clarity and remains untested in the courts. There is also considerable uncertainty about how these provisions would work in practice.
- *Voting of subordinated debt*. Under the BRP regime all secured and unsecured creditors have a voting interest equal to the value of their claim. But creditors whose claims would be 'subordinated in a liquidation' only get to vote at an amount equal to that which the creditor could reasonably expect to receive in a liquidation. This could be a very useful tool to overcome junior creditors that are out of the money. However, the relevant statutory wording is unclear as to whether this provision applies to limited subordination rather than general subordination. It could be argued that this provision applies only to debt which is generally subordinated to all other debt of the company and not to debt which is expressly subordinated to only one or some other classes of debt, for example, mezzanine debt which is contractually subordinated only to the senior debt in the structure. The interpretation of this provision has not been tested in the courts and its meaning and application remains uncertain. This uncertainty creates difficulties as knowing the value of the various creditors' claims for voting purposes will be a key part of the process, affecting both the dynamics between stakeholders and the deliverability of a BR Plan.
- *Limited equity voting rights*. BRP provides that the equity gets a vote on the BR Plan if the plan would alter the rights associated with the class of interests they hold. There is a suggestion that if, as part of a BR Plan, more shares of an existing class are issued to the creditors to dilute the existing shareholders – for example, as part of a debt for equity swap – the existing shareholders would not be considered to be affected and therefore would not be able to vote on the plan. This would have a significant impact on the voting framework. This is another key area of uncertainty which also remains untested in the courts.
- *New money – DIP financing*. A company in BRP is permitted to obtain new funding and can grant security over any unencumbered asset. New funding can be sought by the BR Practitioner on an ad hoc basis or as part of the BR Plan. Any new money provided to a debtor in BRP will benefit from preferential claim status under South African insolvency priority rules.
- *South Africa: jurisdictional risks*. To successfully use BRP, it will be essential to understand the local political and economic interests and dynamics. One key element is the Black Economic Empowerment legislation, which provides that companies in certain industries (for example mining) must be owned by a requisite percentage of ethnically black individuals or black managed organisations. This may have an impact on structuring, for example the ability to implement a debt for equity swap, and on underlying regulatory approvals and licences which may be affected. Understanding the operation and timings of the local court system will also be key. It will be very important to have knowledgeable and experienced local advisors on board.

Conclusion

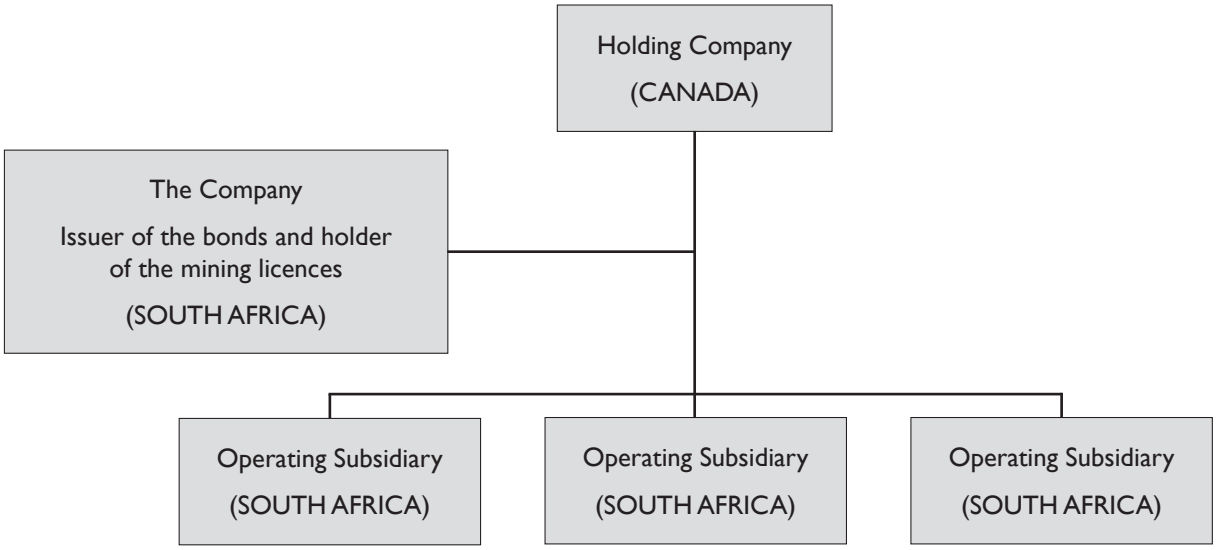
The BRP regime appears to be a usable, constructive and relatively creditor-friendly process and to date it seems that the process is being used in practice in this way. There is still material uncertainty regarding the proper interpretation and practical application of a number of potentially useful provisions in the legislation, which still remain largely untested by the South African courts. That being said, the legislation clearly contains a number of provisions which, on the face of it, could help enable investors in South Africa, particularly senior creditors, to achieve desirable results in any restructuring process, and these areas of uncertainty should be resolved and become established as the BRP process continues to develop over time.

Case study

The following case study has been provided by the South African law firm Bowman Gilfillan and highlights how BRP can be utilised to restructure a South African business with a complex and international capital structure.

Background facts

- The company was one within a group of companies, comprising a holding company (in Canada), and operating subsidiaries. The company itself was an intermediate company which had issued a number of floating interest notes under an indenture. The notes were held via a Global Depository registered on a European bond exchange.
- The group operated in a regulated industry – the mining industry. The sector of the mining industry in which the group operated was very competitive and the company was concerned that any



bankruptcy proceedings at the operating subsidiary level could cause a loss of customers.

- The value of the group (i.e. the value of the group's assets) broke just above the notes.
- The shareholding comprised a management vehicle as well as institutional shareholders.
- The notes were highly geared and the company was not going to be able to meet the payments due on maturity. A default under the notes was looming and inevitable.
- There were tensions between shareholders, and between shareholders and management. The noteholders wanted to recoup some value by converting their debt into equity. The shareholders wanted to see a term-out or a haircut on the debt (or margin) without compensation by equity.
- Funding was urgently required to pay the trade creditors of the operating subsidiaries as the creditors were threatening to withhold deliveries. However, the group was unable to procure funding from commercial banks. The noteholders were prepared to fund trade creditors in principle but were reluctant to do so in a situation where the group was potentially trading while insolvent.
- There were cross-guarantees and cross-suretyships between the company and the holding company.

Rescue

The holding company was placed into administration in Canada, and the intermediate company was placed into BRP in South Africa.

The BRP solved the following issues:

- The simultaneous imposition of BRP in South Africa and administration in Canada prevented any enforcement arising from the cross-defaults between the holding company and the company.
- The BRP created an immediate moratorium at the company level which precluded any enforcement action by the noteholders. As the BRP was not invoked at operating subsidiary level, there was no moratorium in place at the operating subsidiaries – but the trade creditors of the operating subsidiaries were pacified by payment of the arrear amounts.
- The regulatory mining licences were not affected by the BRP. South African mining legislation provides that mining licences terminate on final liquidation of the licence holder.
- The noteholders were prepared to fund the trade debts because, by advancing funds to the company (for onward loan to the operating subsidiaries) after the commencement of the BRP, the funding was given a statutory preference over all other unsecured creditors.
- The appointment of the BR Practitioner created a new channel for communication by side-stepping the fraught relationship between management and the shareholders and between management and the noteholders.
- By not placing the operating subsidiaries into BRP, the group was able to describe the restructuring to the market as a corporate restructuring rather than a full blown bankruptcy of the group.
- A BR Plan was finally agreed with the noteholders in terms of which the notes were swapped for new bonds with a longer term and higher interest, and a small portion of the notes were converted to equity.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

Alongside its regular features – Editorial, The US Corner, Economists' Outlook and Case Review section – each issue of *International Corporate Rescue* brings superbly authoritative articles on the most pertinent international business issues written by the leading experts in the field.

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- Identify and assess potential problems and avoid costly mistakes.

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