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Advertising & Marketing Arts & Leisure Business Business in Africa Companies Cover Story Current Affairs Economy & Markets FM Focus Front of the Book Opinion People Personal Wealth Weekly Property Technology Did You Hear?	18 June 2004 LIQUIDATION INDUSTRY Overview RESCUE REMEDY By Jacqui Pile Existing legislation is geared towards liquidating ailing companies rather than assisting them	 Pat
Special Reports	<p>The liquidations industry is in desperate need of a clean-up. Widespread allegations of corruption and bribery in various high court masters' offices and the questioning of the potentially large fees that liquidators can earn for winding up companies have led to a call for the industry to be regulated.</p> <p>Though SA is one of the most competitive countries in which to do business, it has an unhealthy number of liquidations. This is something that a country with high unemployment and turgid growth can't afford.</p> <p>Daly Incorporated director Patrick Daly says: "Liquidation is being used increasingly as a debt-collection tool in some companies that could be saved. The effect on jobs and the economy is devastating."</p> <p>The liquidations industry is a huge cash spinner, worth about R8bn/year. Compulsory company liquidations varied between 60/month and 80/month between 1994 and 1999. During the following three years, the figure dropped steadily to 27/month in 2002, but increased to 35/month in 2003, mainly due to the strengthening rand, which put pressure on export businesses. Liquidations averaged about 21/month for the first three months of this year.</p> <p>Government and the private sector plan to overhaul the legislative framework, which is geared towards liquidating - rather than rescuing - potentially vibrant businesses in distress. The new buzzword is business rescue.</p> <p>"The purpose of business rescue is not necessarily to prevent a company from being wound up or liquidated," says University of Pretoria associate professor David Burdette. "But even if the business cannot be restored to a solvent and profitable status, business rescue has shown that the return to creditors in the long run will be higher."</p> <p>He says corporate rescue and reorganisation is based on the idea that in many cases an ailing company not only has value as a going concern, but that this value exceeds its liquidation value. During a liquidation, there are a number of players that take a cut: auctioneers pocket about 10% of realised assets, attorneys about 5% and liquidators another 10%.</p> <p>"In an average liquidation, between 30% and 40% of the value of the assets is lost during the process," says Corporate Renewal CEO Jan van der Walt.</p> <p>Though SA was one of the first countries to make provision for business rescue - through the judicial management provisions in the Companies Act - there hasn't been much success in implementing it.</p> <p>Burdette says companies that are experiencing a temporary financial setback as a result of mismanagement or other special circumstances can use the process. The idea is that by replacing the existing management of the company with a judicial manager who takes over the company's business, the company can be restored to profitability.</p>	 Dav
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"The courts take a conservative approach to insolvency, which has contributed to the failure of a judicial management as a business rescue regime," says Burdette. "It is seen as an extraordinary measure, whereas in other jurisdictions, business-rescue procedures are seen as a necessary and natural precursor to insolvency itself."

The problem is, however, who will take responsibility for creating a legislative framework that supports business rescue?

Players in the industry have tried to co-ordinate efforts to lobby government to amend legislation. It's unclear, however, which department will be responsible for driving the changes. Insolvency legislation is written by the justice department, but the department of trade & industry (DTI) is the guardian of the Companies' Act. The labour department also has an interest in new laws, because liquidations affect so many jobs.

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There are also large divisions in the business-rescue industry, which includes lawyers, accountants, some liquidators, general business people, creditors and so-called specialists. Various proposals have been made to the state law adviser Enver Daniels on how to formalise and amend the system.

The justice department appears to be driving a model developed by Daly Incorporated. The concept proposes an interim model for rescue utilising current legislation until a new rescue bill has been drafted.

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The overriding principles of the new act would be to establish a business-rescue regime, with the appointment of a business-rescue professional to a company at an earlier stage to help turn the business around.

But Burdette, after consulting a wide range of players, is calling for a revamp of the entire system. He has consolidated insolvency laws scattered across the Companies Act, the Insolvency Act and the Close Corporations Act, in a unified Insolvency & Business Recovery Bill.

"We've managed to reduce more than 1 000 sections across different acts into a single piece of legislation with 192 sections," says Burdette.

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He says insolvency and business rescue go hand in hand and the new unified act has been designed to accommodate a new business-rescue model. Most players support a consolidated approach to insolvency, but some feel it is unworkable.

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Daly says: "Our insolvency law, save for the absence of business-rescue provisions, is among the best in the world. Almost every clause has been interpreted and precedents have been set. A rewritten insolvency act would introduce great uncertainty about interpretation."

But Burdette says the new act changes little of the substantive law of insolvency that has been built up by statute and common law over the decades. Instead, it focuses on making insolvency law more user-friendly.

"Ironically, it's the fact we have fragmented insolvency legislation that gives rise to interpretation problems."

Whatever model is chosen, other weaknesses in the judicial management provisions will have to be addressed.

Current law requires a company to be technically insolvent - unable to pay its debts - before a judicial management order can be granted.

"It defeats the object of business rescue, which is to stave off insolvency," says Burdette. "The earlier a company gets assistance, the more chance there is of it becoming a going concern."

Both Daly and Burdette's approach is to control the process by shortening the time period for turnaround specialists to report to creditors.

Werksmans director Paul Winer says the bureaucracy involved in granting a judicial management order can take up to three months, by which time it is difficult to implement successful turnaround procedures.

Burdette suggests insolvency and business-turnaround legislation should be linked to corporate governance by encouraging directors to come forward as soon as they know their companies are in trouble. In the US and Australia, directors can be held responsible for negligence if they try to trade their way out of insolvency without seeking assistance. Daly confirms that current legislation already has similar provisions that could be enforced with the implementation of a proper legislative rescue process.

One of the most important proposals in both models is that an automatic moratorium on all creditors should also be included to protect vulnerable companies.

The informal business-rescue framework in SA doesn't give companies the legal clout to keep all creditors from liquidating them to recover debt. This means that though certain creditors may be willing to give the company a chance, others are entitled to make use of liquidation to recover their payments - and they often do. Amendments to the legislation would bind minority dissenting creditors too.

Daly is also proposing a *consensus creditorum* - the freezing of creditors' and employees' positions at the time a company is placed under administration. This would protect creditors' and employees' positions.

But there is disagreement over how business-rescue practitioners should be appointed.

The master of the high court appoints liquidators from a panel. Daly is calling for a separate panel of business-rescue specialists to be appointed by the master. He says this is because liquidators have been trained to liquidate the assets of the company, not to save them. Conflict also arises as a result of the fee structure for liquidators because their payment is based on a percentage of realised assets, not on saving the company.

But Burdette says many liquidators have the skills to turn businesses around and they should be included in the process.

"The master of the high court should have no role in the appointment of business administrators," he says. "The task should be left to the creditors and employees of the company."

He's proposing an entrance exam for the panel of turnaround specialists that would cover legal, accounting and management aspects.

Informal turnaround players plan to set accreditation and qualification standards for the profession soon, by means of a centralised body.

The process of driving the legislation through parliament will need three important players' support: organised labour, the SA Revenue Service (Sars) and financial institutions.

Financial institutions are assisting the justice department in the drafting of the new business-rescue bill.

Organised labour will only support legislation if it protects workers in distressed companies, but it may have to compromise on clauses aimed at genuine attempts to save jobs.

Sars may have to compromise too. Tax authorities get certain preferences on recoveries in liquidations, so potential funders are reluctant to step in if they may not be repaid at the end.

Government needs to co-ordinate efforts, consult widely and develop legislation in a transparent manner.

Meanwhile, the fledgling business-rescue industry is preparing for statutory changes that will hopefully help it restore sick companies to health.



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