

“Reasonable possibility” versus “reasonable prospect”: Did business rescue succeed in creating a better test than judicial management?

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OPSOMMING

“Redelike waarskynlikheid” versus “redelike vooruitsig”: Het ondernemingsredding daarin geslaag om ’n beter toets as geregtelike bestuur daar te stel?

’n Nuwe Maatskappywet 71 van 2008 het op 1 Mei 2011 in Suid-Afrika in werking getree. Suid-Afrika het daardeur ’n nuwe korporatiewe reddingsstruktuur, naamlik ondernemingsredding, gekry. Hierdie nuwe invoeging in die Wet in Hoofstuk 6 is deur baie belanghebbendes met afwagting ingewag. Een van die redes was om te sien of die foute wat in die vorige bedeling met geregtelike bestuur gemaak is, oorkom sou wees met die nuwe struktuur.

Hierdie artikel ondersoek spesifiek die bewyslas vir ondernemingsredding soos in die 2008-wet gestel met verwysing na die hantering van die konsep “redelike vooruitsig” deur die howe.

Dit word aan die hand gedoen dat die howe ’n te streng uitleg aan hierdie bewyslas heg en dat dit daartoe bydra dat min aansoeke vir ondernemingsredding slaag.

1 INTRODUCTION

The long awaited new Companies Act¹ came into operation on 1 May 2011. The second anniversary of this event was recently celebrated. A new corporate rescue structure, namely, business rescue was one of the eagerly awaited introductions contained in Chapter 6 of the Act. The objective with business rescue is to keep companies alive and prolong the benefits that so many stakeholders, employees, shareholders and creditors, receive from it.² The new rescue procedure was also aimed at aligning South Africa’s rescue procedure with those of international jurisdictions such as the United States of America, the United Kingdom and Australia.³

1 71 of 2008.

2 *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd* 2012 2 SA 423 (WCC) para 2; *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd*; *Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd* 2012 3 SA 273 (GSC) para 12.

3 *South African company law for the 21st century. Guidelines for corporate law reform* GN 1183 GG 26493 of 23 June 2004 3; Levenstein “Shifting mindsets” *Without Prejudice* Oct 2011 29.

South Africa was in dire need of a workable corporate rescue model after the previous one, judicial management, had failed ailing companies in the previous company law regime. Judicial management has been criticized for many years by various writers.⁴ Smits described judicial management as a “spectacular failure”⁵, Stein and Everingham referred to it as “an abject failure”⁶ and Josman J finally administered the lethal injection to this corporate rescue procedure in *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd*⁷ where he referred to judicial management as a “system which has barely worked since its initiation in 1926”.⁸

The disadvantages of judicial management included the following:

It was described as a “cumbersome and ineffective procedure”;⁹

the “high threshold of proof required”, namely, a reasonable probability for the granting of the order;¹⁰ and

a stigma was attached to judicial management. It was labelled as “an extraordinary remedy which infringes on the rights of creditors”.¹¹

Business rescue is one of the main themes of the 2008 Act. One of its objectives as contained in section 7 is that provision must be made to rehabilitate companies that struggle financially in a manner that balances the rights of all stakeholders involved.¹²

The purpose of this article is to provide a brief historical overview of the corporate rescue structures in South African company law, to examine the way in which the judiciary grappled with the recovery requirement contained in Chapter 6 and to explore possible ways in which the problematic interpretation and application thereof by the courts can be rectified.

2 BRIEF HISTORICAL BACKGROUND OF SOUTH AFRICAN RESCUE PROCEDURES

2.1 Introduction

Judicial management was first introduced in South Africa in the 1926 Companies Act.¹³ With this enactment, South Africa was one of the first countries, if not the first, to introduce a statutory corporate rescue mechanism.¹⁴

4 See amongst others Loubser “Judicial management as a business rescue procedure in South African corporate law” 2004 *SA Merc LJ* 137 for a detailed discussion of judicial management.

5 Smits “Corporate administration: A proposed model” 1999 *De Jure* 85.

6 Stein and Everingham *The new Companies Act unlocked* (2011) 409.

7 [2001] 1 All SA 223 (C) para 55.

8 Para 60.

9 *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* 2012 2 SA 423 (WCC) para 20.

10 Burdette “Unified insolvency legislation in South Africa: Obstacles in the path of the unification process” 1999 *De Jure* 57 58 and Smits 96.

11 Loubser *Some comparative aspects of corporate rescue in South African company law* (LLD thesis UNISA 2010) 43; Kloppers “Judicial management – A corporate rescue mechanism in need of reform?” 1999 *Stell LR* 426.

12 S 7(k) of the 2008 Act.

13 Act 46 of 1926.

Although many writers and judges regarded judicial management as an unsuccessful rescue mechanism,¹⁵ the Van Wyk de Vries Commission regarded it sufficient to recommend that it be retained in the 1973 Companies Act.¹⁶

Since 2000 there have been various attempts to bring the South African rescue procedure in line with more modern procedures. These included a draft Insolvency and Business Recovery Bill, a Government-backed fund for making funds available to struggling companies and a Business Rescue Bill.¹⁷

In May 2004 the Department of Trade and Industry published a Policy Paper which stated that “a system of corporate rescue appropriate to the needs of a modern South African economy” will be envisaged by the law review process.¹⁸

2.2 Concepts and interpretational hurdles

Section 427 of the 1973 Companies Act which dealt with judicial management provided as follows:

“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.”¹⁹

This section in the 1973 Act was a mere duplicate of section 195 of the 1926 Companies Act which also included judicial management as corporate rescue procedure.²⁰

The uncertainty regarding the exact meaning of the phrase *reasonable probability* is not novel to our company law. In *Noordkaap Lewendhawe Ko-operasie Bpk v Schreuder*²¹ Van Blerk AJ held the difference between the words *probable* and *possible* to be material.²² He expressly stated that in legal terminology something that is possible is less sure to happen than something that is probable.²³ This case was decided on the phrase *reasonable probability* in section 195(1) of the 1926 Companies Act.²⁴

14 The English Companies (Consolidation) Act of 1908 8 Edw VII 7 (c 69) did not contain a rescue procedure and the Australian voluntary administration proceedings was introduced by the Corporate Law Reform Act in 1992 in Part 5.3A of the Australian Corporations Law; Loubser *Thesis* 2; Sellars “Corporate voluntary administration in Australia” paper prepared for the Forum for Asian Insolvency Reform 2001 1–2.

15 See *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd* [2001] 1 All SA 223 (C) 238; Burdette 1999 *De Jure* 57 58; Smits 96; Loubser *Thesis* 43; Kloppers 1999 *Stell LR* 426.

16 Act 61 of 1973.

17 For a discussion of these attempts see Loubser *Thesis* 4.

18 *South African company law for the 21st century* 45.

19 S 427(1), own emphasis.

20 Act 46 of 1926.

21 1974 3 SA 102 (A).

22 110.

23 *Ibid.*

24 Act 46 of 1926.

Chapter 6 of the 2008 Act uses the term *reasonable prospect* as a new description for the “recovery requirement”²⁵ which is required as part of the burden of proof for an order for business rescue to be granted.

There is no definition of the phrase “reasonable prospect of rescuing a company” in section 128 of the 2008 Act. Although various other phrases and words used in Chapter 6 are defined in section 128, “rehabilitation” is not defined. This is unfortunate as the interpretation of *reasonable probability* as contained in both the 1926 and 1971 Company Acts was problematic.

2.3 Criticism from academia

Burdette²⁶ listed the requirement that there must be a “reasonable probability” as the second main problem experienced with judicial management and also put this forward as one of the reasons why judicial management could not have been successfully implemented in South Africa. According to him the preferred test should have been a reasonable possibility.²⁷ Kloppers labelled this requirement “outdated [and] unrealistic”.²⁸

It is unfortunate that, despite the abundance of criticism regarding judicial management and especially the use of the requirement of reasonable probability, the legislature overlooked the need for a clearly formulated burden of proof in the new business rescue regime.

2.4 “Reasonable prospect” in the 2008 Act

The 2008 Act provides for a dual gateway to commence business rescue proceedings. Firstly, a voluntary route is provided for by the Act in section 129(1). According to this pathway, the board of directors can resolve to place the company in business rescue provided that they have reasonable grounds to believe that the company is struggling financially and there is a *reasonable prospect* that the company can be rescued.²⁹ Section 131(4) of the 2008 Act sets out the requirements that must be proven by an affected party³⁰ when application is made to the court to start business rescue proceedings. According to section 131(4)(a) a court may make an order placing a company in business rescue provided that the court is satisfied that

“(i) the company is financially distressed; (ii) the company 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* (own emphasis) for rescuing the company”.

Despite the fact that many writers³¹ recommended the use of the phrase “reasonable possibility”, the term used in the 2008 Act is “reasonable prospect”.³²

25 The reference used by Eloff AJ in *Southern Palace* when he referred to the burden of proof.

26 Burdette “Some initial thoughts on the development of a modern and effective business rescue model for South Africa (Part 1)” 2004 *SA Merc LJ* 249.

27 *Ibid.*

28 Kloppers “Judicial management reform – steps to initiate a business rescue” 2001 *SA Merc LJ* 362.

29 S 129(1)(a) and (b).

30 As defined by s 128(a) of Act 71 of 2008.

31 Burdette 2004 249 fn 39; Loubser *Thesis* 339.

32 S 129(1) and 131(4)(a) of the 2008 Act.

In the dictionary definitions of the two words a clear difference is noticeable. The word “probability” is defined as “the extent to which something is probable” and “probable” is defined as “likely to happen or be the case”.³³ “Prospect” on the other hand is defined as “the possibility or likelihood of some future event occurring”.³⁴ If one considers the definitions of these two concepts it is clear that something completely different is set as objective and that the likelihood of the object happening differs significantly. A common synonym given for both these words is the word “possible”.³⁵

It is important not to see the requirements of reasonable prospect contained in the new Act and reasonable possibility used in the old Act as separate from the rest of the objective associated with them. The complete phrase must be kept as a unit, therefore the interpretation and meaning of “reasonable prospect for rescuing the company”³⁶ and “a reasonable probability that the company would be able to pay its debts and become a successful concern”³⁷ need to be clear. The outcome of the applications in the case of judicial management and business rescue differs vastly. It is clear from the definition of business rescue in section 128(1)(b) that any one of two outcomes of business rescue will be seen as a successful rescue of an ailing company. The primary objective is that the company will be able to return to trade on a sound financial footing after the business rescue plan was implemented. The accomplishment of the alternative object will also satisfy the idea of a successful rescue, and that is the better return for the company’s shareholders and creditors when the dividend available to them under business rescue is more than what would be available to distribute to them in the event of the liquidation of the company.

This second aim contained in section 128(1)(b)(iii) was debated in a number of cases.³⁸ The uncertainty regarding this requirement and the question whether the fulfilment of the alternative object of business rescue will be sufficient to constitute a successful rescue as envisaged by the Act was dealt with by the Supreme Court of Appeal in *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd*.³⁹ In this case Brand JA referred to the debate that existed regarding the alternative object and with reference to Australia’s acknowledgement and use of a similar alternative objective in their voluntary administration procedure concurred with previous national decisions that also regarded the accomplishment of the alternative object as a successful rescue.⁴⁰ It is submitted that the uncertainty that existed regarding the alternative object and the judicial confusion are now settled.

33 *The concise Oxford dictionary* 10th edition; edited by Judy Pearsall 1139.

34 *Idem* 1148.

35 *Idem* 1117.

36 The recovery requirement in the 2008 Act.

37 The recovery requirement in the 1973 Act.

38 *AG Petzetakis International Holdings Limited v Petzetakis Africa (Pty) Ltd* 2012 5 SA 515 (GSJ); *Nedbank Ltd v Bestvest 153 (Pty) Ltd* *Essa v Bestvest 153 (Pty) Ltd* 2012 5 SA 497 (WCC).

39 (609/2012) [2013] ZASCA 68 (27 May 2013) paras 23–26.

40 *Ibid* para 24; *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd* 2012 2 SA 423 (WCC); *Koen v Wedgewood Village Golf and Country Estate (Pty) Ltd* 2012 2 SA 378 (WCC); and *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd* 2013 1 SA 542 (FB).

It is submitted that there might be a different interpretation of the reasonable prospect requirement depending on the route taken.⁴¹ This submission is made based on the knowledge available to the different applicants as to the different routes. The directors have the benefit of having the financial affairs of the company at their disposal when assessing whether there is a reasonable prospect to rescue the company. On the other hand, affected persons, which include shareholders, creditors and employees, do not readily have this type of information available to them to assess whether they will be able to comply with the recovery requirement set by section 131(4)(a).⁴²

3 INTERPRETATION OF THE PHRASE “REASONABLE PROSPECT” BY SOUTH AFRICAN COURTS

3.1 *Swart v Beagles Run Investments 25 (Pty) Ltd*⁴³

The first application for business rescue in *Beagles Run* was a compulsory application to the court by the sole director and shareholder of the company to place the company in business rescue.

Makgoba J referred to business rescue as “a new innovation and without precedent in our law”.⁴⁴ Unfortunately, directly after it was acknowledged that business rescue was a novelty in our law, Makgoba J turned to section 427 of the 1973 Act to determine whether the company in question would be able to become a “successful concern” after the proposed business rescue proceedings. It is unfortunate that this reference to section 427 of the 1973 Act was made as the new business rescue procedure does not contain the words *successful concern* as part of the recovery requirement. Business rescue is defined in section 128(b) of the 2008 Act and the phrase “rescuing the company” reverts back to the objectives as explained in section 128(b).⁴⁵ The objective of the 2008 Act’s rescue procedure does not limit the success of such procedure to the company becoming a successful concern as envisaged by the 1973 Act. According to section 128(b)(iii) the company’s continued existence on a solvent basis is not the sole objective of business rescue. This section provides for an alternative. It will also be seen as a successful rescue operation if creditors or shareholders receive a better return compared to what they would have received if the company was liquidated.⁴⁶

The application for business rescue was turned down by the court with costs. Mokgoba J concluded his judgement by stating that there is “no basis for contending that the respondent will be able to carry on business on a solvent basis or that there is any *prospect* thereof”.⁴⁷

41 See Delpont *Henochsberg on the Companies Act 71 of 2008* (2012) (hereafter Henochsberg) 452 463 464 for a discussion of the dual gateway and the burden of proof of the recovery requirement and some uncertainty that might exist depending on the various stages of the application and the burden of proof.

42 *Henochsberg* 464; *Employees Solar Spectrum Trading 83 (Pty) Ltd v Afgri Operations Ltd and Solar Spectrum Trading 83 (Pty) Ltd* unreported case no 6418/2011, 18624/2011 and 66226/2011 (NGC) para 18.

43 2011 5 SA 422 (GNP).

44 Para 23.

45 S 128(h).

46 S 128(b)(iii); *Henochsberg* 444; *AG Petzetakis International Holdings Limited v Petzetakis Africa (Pty) Ltd* 2012 5 SA 515 (GSJ) para 12.

47 Para 42, my emphasis.

3 2 *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd*⁴⁸

This is probably one of the most important cases on business rescue. This is probably due to two reasons. The first is that it was one of the very first cases that dealt with business rescue, and the second is the unfortunate handling of the very important recovery requirement.

In this application for business rescue Eloff AJ turned to a discussion of the new recovery requirement contained in the 2008 Act and expressly indicated the use of different language in the new Act⁴⁹ is an indicator that the recovery requirement contained in Chapter 6 was less stringent than the one required in terms of section 427(1) of the 1973 Act, namely, a reasonable probability.⁵⁰ Eloff AJ mentioned that the fact that “something less” is required in the case of business rescue is a consequence of a different mind-set that is associated with business rescue.⁵¹ The mind-set that accompanied judicial management in the previous corporate rescue regime was one that favoured liquidation versus a rescue regime that is evident from section 7(k) of the 2008 Act.

Even though Eloff AJ referred to the discretion of the court⁵² it was submitted that the court should give consideration to the “legislative preference for rescuing ailing companies if such a course is reasonably possible”.⁵³ Unfortunately, Eloff JA then on examining the case before the court remarked that when looking at the information the court had to work with, there was “no reason to believe that there is any prospect of the respondent being restored to a successful one”.⁵⁴ By using the phrase “a successful one” Eloff AJ applied the burden of proof that was required in terms of judicial management and completely ignored the alternative object created in section 128(b)(iii).

Eloff AJ considered the meaning of the words *reasonable prospect* by looking at various factors that would indicate the existence of a reasonable prospect in a given case.⁵⁵ These factors that go beyond looking at a mere possibility of success or the providing of information “that goes beyond mere speculation or conjecture”,⁵⁶ were criticised by following judgments⁵⁷ and authors as putting the “benchmark too high”.⁵⁸

Despite the fact that Eloff AJ acknowledged that every case must be judged on its own merits⁵⁹ he created a sort of check list that must be used before a court should grant a business rescue application. He identified the following aspects

48 2012 2 SA 423 (WCC).

49 Act 71 of 2008.

50 Act 61 of 1973.

51 Para 21.

52 Para 22.

53 *Ibid.*

54 Para 23, own emphasis.

55 Para 24.

56 *Henochsberg* 464.

57 See *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd* 2013 1 SA 542 (FB) and *Newcity Group (Pty) Ltd v Pello NO, China Construction Bank Corporation Johannesburg Branch v Crystal Lagoon Investments 53 (Pty) Ltd* unreported case [2013] ZAGPJHC 54 (28 March 2013).

58 *Henochsberg* 464 465.

59 *Southern Palace* para 24.

that need to be dealt with in an application to prove to the court that a reasonable prospect exists regarding the company’s ability to continue its existence on a solvent basis:

- the cause of the failure needs to be addressed;
- a remedy for the failure needs to be offered;
- there is a reasonable prospect that the remedy advanced will be sustainable; and
- the above aspects prove, based on “concrete and objective ascertainable details beyond mere speculation”, that the remedy is sustainable.⁶⁰

Although Eloff AJ had the correct idea of creating a kind of check list to enable a court to determine what must be present to prove that a reasonable prospect of rescuing a company is present, the detail required to meet this check list is often not available at the stage where the application for business rescue is brought before the court. The business rescue practitioner has the duty to develop and implement a workable business plan, after various stakeholders have voted on the plan.

It is most unfortunate that this early decision placed the bar too high as it was followed by subsequent judgements which resulted in the same misunderstanding regarding the meaning of reasonable prospect. Only after a number of judgments was a shift in approach noticed.⁶¹

A number of cases will now be discussed with specific reference to the way the court treated the recovery requirement and emphasis is placed on how the judges reverted back, some with affirmation and others with a new approach, to the *Southern Palace* case and Eloff AJ’s interpretation.

3.3 *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd*⁶²

An application for compulsory business rescue was brought before Claassen J in terms of section 131 of Act 71 of 2008. Even though it was common cause that the company in question was financially distressed as defined in section 128(1)(f), the meaning of the phrase *reasonable prospect* was also dealt with by Claassen J. He concurred with Eloff AJ’s view that “something less” is required in terms of the 2008 Act than was the case in the 1973 Act.⁶³ Claassen J went further and stated that if facts were present that showed that there can be a reasonable possibility of rescuing the company, the court might use its discretion and grant the application.⁶⁴ This use of the term *possibility*, strengthens the recommendation made by Loubser.⁶⁵

The application for business rescue was turned down in this case, as liquidation was considered to be the appropriate route to follow.

⁶⁰ *Ibid.*

⁶¹ *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd* 2013 1 SA 542 (FB).

⁶² 2012 3 SA 273 (GSJ).

⁶³ Para 18.

⁶⁴ *Ibid*; see also Bradstreet “Business rescue proves to be creditor-friendly: CJ Claassen J’s analysis of the new business rescue procedure in *Oakdene Square Properties*” 2013 *SALJ* 48.

⁶⁵ Loubser *Thesis* 339.

3 4 *Koen v Wedgewood Village Golf and Country Estate (Pty) Ltd*⁶⁶

In a compulsory application for business rescue, Binns-Ward J, in dealing with the recovery requirement started off by stating that the information needed to prove the existence of a reasonable prospect will depend on the object of the business rescue.⁶⁷ This reference to the different objects contained in section 128(a)(iii), namely, to rehabilitate a company to continue business on a solvent basis or to provide a better return for creditors of the company, means that the information needed to prove the recovery requirement contained in section 131(4)(a) will differ. Binns-Ward J immediately thereafter continued by stating:

“Whatever the object of the proposed business rescue, however, in order to succeed in the application the applicant must be able to place before the court a cogent, evidential foundation to support the existence of a reasonable prospect that the desired object can be achieved.”⁶⁸

This reference is clearly contradictory to the first statement made regarding the information needed to prove the recovery requirement.

Binns-Ward J correctly pointed out that it is the task of a business rescue practitioner, after he is appointed to draft a business rescue plan, to indicate whether there is a reasonable prospect that the company will be able to carry on business on a solvent basis after the business rescue plan was implemented or that the business rescue plan will enable creditors and shareholders to receive a better result from the rescue proceedings than would be the case in liquidation.⁶⁹ Regarding the type of information that needs to be placed before the court in an application based on section 131(4)(a) to show that a reasonable prospect does exist, Binns-Ward J stated that

“[the founding papers] . . . must nevertheless contain sufficient factual detail to enable the court to determine whether the business rescue practitioner will probably have a viable basis to undertake the task, or, at the very least, make out a case for the court to hold that an investigation by a business rescue practitioner to that end, in terms of s 141(1) of the Act, appears to be justified”.⁷⁰

As to the nature and type of information required to satisfy the court of the abovementioned “factual detail”, Binns-Ward J concurred with Eloff AJ’s requirement⁷¹ of “some concrete and objectively ascertainable details . . . going beyond mere speculation”⁷². He expressly stated that “vague and speculative averments” will not be enough to convince the court that a reasonable prospect does exist that the company can be rescued.⁷³ Despite the fact that the exact object of business rescue was not clearly indicated in the founding papers, Binns-Ward J indicated that the applicants have “fallen woefully short of furnishing the court with the material” needed to prove to the court that a reasonable prospect of rescue did exist and the application was dismissed with costs.⁷⁴

66 2012 2 SA 378 (WCC).

67 See *Koen* 10 para 17 of the PDF version of the case. Note that this version contains two paragraphs 17 and 18 and therefore the page numbers are indicated as well.

68 10 para 17.

69 *Ibid.*

70 *Ibid.*

71 10 12 para 18.

72 *Southern Palace* para 24.

73 *Koen* 11 para 18.

74 Para 23.

3 5 *Francis Edward Gormley v West City Precinct Properties (Pty) Ltd*⁷⁵

In this application for business rescue, Gormley, a major shareholder of West City Precinct Properties (Pty) Ltd, applied for the company’s business rescue.

Traverso DJP made it clear that in the event where the object of the application boils down to the benefits derived from the moratorium mentioned in section 128(a)(ii) and the realisation of assets over a three to five-year period, it cannot be within the object contained in section 128(a)(iii). The judge indicated that “not a single fact . . . only generalisations [were] put forward” and that there was a lack of the information needed to prove the recovery requirement as explained by Eloff AJ and Binns-Ward J in the abovementioned cases.

3 6 *Employees Solar Spectrum Trading 83 (Pty) Ltd v Afgri Operations Ltd and Solar Spectrum Trading 83 (Pty) Ltd*⁷⁶

This was the first case since the inception of the new business rescue procedure where employees approached the court as affected persons to apply for a company’s compulsory business rescue. The dispute concerned the question whether there was a reasonable prospect to rescue the company. In his judgment Kollapen J referred to the (in)famous words of Eloff AJ in *Southern Palace*.⁷⁷ Kollapen J expressed his difficulty in understanding the factors mentioned by Eloff AJ.⁷⁸ Although he referred to Eloff AJ’s statement that each case must be evaluated on its own merits, he added that the type of information that is brought before the court by an affected party will depend on the position the specific affected party has toward the company.⁷⁹ This was aptly referred to by the judge as a “balancing exercise”.⁸⁰

In his explanation of the meaning of the word “prospect” Kollapen J referred to the uncertain nature of the word. He explained it as follows: “By its very nature a prospect is future looking and dependent upon a number of variables and includes a level of risk to the extent that the future is hardly capable of accurate prediction.”⁸¹ He concluded that what is required is “a determination . . . that the future prospects of rescuing the business appear to be reasonable”.⁸²

Kollapen J was of the opinion that the employees indeed made out a reasonable prospect that the business may be rescued and granted the application.

3 7 *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd*⁸³

In this case a creditor applied for the compulsory business rescue of a company in financial distress. The question with which Van der Merwe J was confronted was whether there was a reasonable prospect to rescue the company. The court first looked for a meaning of the phrase “reasonable prospect” in section 131(4)(a) of the Act.

⁷⁵ 19076/11 (WCC) 18 April 2012.

⁷⁶ Unreported case no 6418/2011, 18624/2011 and 66226/2011 (NGC).

⁷⁷ Para 15, referring to *Southern Palace* para 24.

⁷⁸ Para 17.

⁷⁹ *Ibid*.

⁸⁰ *Ibid* 17.

⁸¹ Para 34.

⁸² *Ibid* 34.

⁸³ 2013 1 SA 542 (FB).

Van der Merwe J started his search for the meaning of this phrase by looking at the meaning of “rescuing the company” contained in section 128(1)(h) of the 2008 Act.⁸⁴ According to this definition a company will be rescued if one of two goals have been met. These are firstly, if the company can continue doing business on a solvent basis or if a company’s creditors or shareholders receive a better dividend in terms of business rescue than would have been the case under liquidation.⁸⁵ Following suit as did almost all previous cases, Van der Merwe J turned to Eloff AJ’s interpretation of the phrase in *Southern Palace* and he agreed with the judge’s viewpoint that the 2008 Act required something less than its 1973 predecessor.⁸⁶

Van der Merwe J firmly stated that there can be no question about the fact that “a factual foundation for the existence of a reasonable prospect that the desired object can be achieved” must be placed before a court in an application for business rescue proceedings.⁸⁷ Although he concurred with the viewpoint expressed by Eloff JA, Van der Merwe J remarked that Eloff AJ in *Southern Palace* as well as Binns-Ward J in *Koen* expected too much of the applicants in order to prove to the court that a reasonable prospect did indeed exist.⁸⁸

Regarding the meaning of this phrase, Van der Merwe J stated that “a prospect . . . means an expectation [and] it therefore signifies a possibility. A possibility is reasonable if it rests on a ground that is objectively reasonable”.⁸⁹ Van der Merwe J formulated a new test for the recovery requirement by stating that “a reasonable prospect means no more than a possibility that rests on an objectively reasonable ground or grounds”.⁹⁰ Van der Merwe J did not deem it appropriate to create a check list of basic information that would satisfy the recovery requirement as formulated by him.⁹¹

Although it appears that Van der Merwe J formulated a lower burden of proof he dismissed the application for business rescue.

3 8 *Zoneska Investments (Pty) Ltd t/a Bonatla Properties (Pty) Ltd v Midnight Storm Investments 386 Ltd*⁹²

In this case the question was whether placing the company in business rescue would result in a better return for creditors. Stelzner AJ interpreted “prospect” to mean “possibility”⁹³ and explained that even though specific detail does not need to be spelt out by the applicant,⁹⁴ facts need to be placed before the court and these facts cannot comprise of “speculative suggestions”.⁹⁵ Although Stelzner AJ acknowledged the fact that “there cannot be a checklist approach to business rescue applications”⁹⁶ he stated that enough facts need to be placed before the

84 See para 6.

85 See para 7, s 128(1)(h) of the 2008 Act.

86 See para 8.

87 See para 11.

88 See para 11.

89 See para 12.

90 See para 12.

91 See para 15.

92 [2012] 4 All SA 590 (WCC).

93 See para 40.

94 See para 48.

95 See para 47.

96 See para 53.

court by the applicant to enable the court to decide on the success of the plan, including “an assessment of the practical feasibility of the plan”.⁹⁷ It seems that Stelzner AJ followed the same direction as that followed by Eloff JA in *Southern Palace* where the information needed in a business rescue application was already treated as information needed for the plan. The problems regarding such an approach have already been dealt with in detail above.

The application for business rescue was dismissed due to the many difficulties that existed and since according to Stelzner AJ “no reasonable prospect [existed] that the proposed plan will have the benefit for creditors which is claimed”.⁹⁸

3 9 *Newcity Group (Pty) Ltd v Pellow, China Construction Bank Corporation Johannesburg Branch v Crystal Lagoon Investments 53 (Pty) Ltd*⁹⁹

In this case it was pointed out that conflicting viewpoints exist as to exactly how a court should determine whether the recovery requirement has been proved.¹⁰⁰ Van Eeden AJ referred to some of the cases that also dealt with the phrase “reasonable prospect” and the way it was interpreted and applied. He started with *Southern Palace* and pointed out that when Eloff AJ had to decide whether a reasonable prospect existed in that case, he did not have a precedent to follow.¹⁰¹ The approach then used by Eloff AJ was approved in many subsequent cases¹⁰² and only in one of the later cases¹⁰³ Van der Merwe J cautioned that the bar must not be placed too high.

Van Eeden JA made it clear that a reasonable prospect must be present “without speculation”.¹⁰⁴ His summary of the recovery requirement is as follows:

“If objectively there is a possibility or likelihood of those uncertain future events (with reference to the eventual rescue of the company or a better return) occurring, the jurisdictional requirements have been satisfied, and the court can exercise its discretion.”¹⁰⁵

He acknowledged that every case must be judged on its own merits and facts and that less is required in some instances.¹⁰⁶ Although Van Eeden AJ agreed with the guidelines laid down by Eloff AJ in *Southern Palace*,¹⁰⁷ he also agreed with Van der Merwe J that the bar must not be placed too high.¹⁰⁸ According to Van Eeden JA a suitable test “should be flexible and the circumstances of each case

97 See para 51.

98 See para 86.

99 Unreported case [2013] ZAGPJHC 54 (28 March 2013).

100 Para 11.

101 *Ibid.*

102 *Koen v Wedgewood Village Golf & Country Estate (Pty) Ltd* 2012 2 SA 378 (WCC); *Zoneska Investments (Pty) Ltd t/a Bonatla Properties (Pty) Ltd v Midnight Storm Investments Ltd (Reg no: 2007/019270/06) (Grayhaven Riches 9 Ltd and others as Interested Parties; First Rand Bank as Intervening Creditor)* [2012] 4 All SA 599 (WCC); *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd (Marley Pipe Systems (Pty) Ltd Intervening)* 2012 5 SA 515 (GSJ); *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa v Bestvest 153 (Pty) Ltd* 2012 5 SA 497 (WCC).

103 *Propspec* paras 11 12 15.

104 *Newcity* para 14.

105 *Ibid.*

106 *Ibid.* Eloff AJ also acknowledged this fact in *Southern Palace* para 24.

107 Para 24.

108 *Propspec* paras 11 12 15.

will determine whether viable facts give rise to a reasonable prospect or not”¹⁰⁹ and “speculation cannot create a reasonable prospect”.¹¹⁰

It is submitted that Van Eeden AJ added value by indicating what will satisfy the quest for proof of a reasonable prospect.¹¹¹ The following will indicate whether a reasonable prospect does exist: first, the difference that will be made by replacing existing management by new management; second the chances of the business rescue practitioner to use his power in terms of section 136(1) of the Act to suspend loan agreements and to cancel the management contract and third the possibility of acquiring post commencement financing in terms of section 135(1) of the Act. Van Eeden AJ dismissed the application for business rescue on the grounds that a reasonable prospect was not present as the replacement of management does not create a reasonable prospect that the company can be saved¹¹² and nothing materialised regarding third party funding and no prospect existed regarding the possible acquiring thereof.¹¹³

3 10 *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd*¹¹⁴

The Supreme Court of Appeal had the opportunity to interpret the very controversial recovery requirement in this case. Only some of the relevant *dicta* are referred to.

Firstly Brand AJ, on behalf of a full bench, stated that the question whether there is a reasonable prospect for rescuing a company can only be answered with a yes or no and it entails a kind of value judgement.¹¹⁵ Even though the court acknowledged that the test used in chapter 6 is a lesser requirement than the burden referred to in section 427 of the 1973 Act, it was emphasised that something more than a mere “arguable possibility” is required to establish a reasonable prospect.¹¹⁶ According to the court the emphasis must not be on *prospect* alone, but rather on *reasonable*, thus a “prospect based on reasonable grounds” set out by the appellant in the founding papers.¹¹⁷ Brand JA considered the earlier check-list approach started in *Southern Palace* and summarised the preferred approach to the recovery requirement by stating that it would not be “practical, nor prudent” to support a check-list approach to set out the way in which the recovery requirement must be proven.¹¹⁸

5 CONCLUSION

It is clear from the discussion above that the single most problematic factor that stands in the way of the granting of business rescue orders, is the uncertainty experienced by the courts regarding the meaning of “reasonable prospect”. It is submitted that one major reason for this uncertainty is the high bar that has been

109 Para 14.

110 Para 23.

111 Discussed in para 17 by referring to the paragraphs in the affidavit.

112 Para 20.

113 Paras 21-23.

114 (609/2012) [2013] ZASCA 68 (27 May 2013).

115 Para 21.

116 Para 29.

117 *Ibid.*

118 Para 30.

set by Eloff AJ in *Southern Palace*. Ever since, every decision dealing with a business rescue application where it was common cause that the company was financially distressed and the issue involved was whether there was a reasonable prospect that the company can be rescued, the guidelines as discussed by Eloff AJ were referred to. The reference made by Eloff AJ to the business rescue plan at that early commencement stage seems to have stuck in the minds of almost all later judges and that resulted in a threshold that is too high. One must remember that a similar high threshold, even though not exactly the same, caused judicial management to fail as a successful corporate rescue mechanism.

It is submitted that the *reasonableness* approach that was started by Van der Merwe J in the *Propspec* decision and confirmed in the appeal case can be seen as a constructive approach to the many difficulties encountered in proving the recovery requirement.

Even though a clear definition of the recovery requirement has not yet been developed by the courts, the bar has been lowered and a more versatile approach has been advocated that will surely enable the courts in future business rescue applications to deal with the recovery requirement in a swift and easy manner without placing the bar too high.