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# CHAPTER 1
# GENERAL INTRODUCTION

## 1 1 Background and introduction

Since 1926 when judicial management was introduced by the Companies Act 46 of 1926, South African company law has provided for the rescue of financially distressed companies. Judicial management was not regarded as a successful corporate rescue procedure and for most of its existence it was criticised, especially by courts who thought that it should only be applied in extraordinary circumstances.[1]

It became apparent to government that there was an urgent need to reform South Africa's company laws. In June 2004 the Department of Trade and Industry published a policy paper[2] which stated that judicial management was seldom used and even more rarely led to a successful rescue. Ms Brigitte Mabandla, the then Minister of Justice and Constitutional Development, declared in her budget speech[3] in Parliament on 22 June 2004 that the emphasis should be on business rescue rather than liquidation with a view to protecting the economy, workers and their families, creditors and others. She expressed the view that a regulatory environment focusing on rescue rather than liquidation would instil greater investment confidence in the country and the economy.[4] The introduction of modern business rescue principles was a step forward in making South Africa more competitive and bringing it in line with the modern global economy.[5]

With the introduction of business rescue[6] into South African law through the new Companies Act 71 of 2008,[7] many fear that the process will be abused by debtors who might want to use the protection granted by the automatic moratorium[8] as a de-

1 *Silverman v Doornhoek Mines Ltd* 1935 TPD 349 353; *Sammel v President Brand Gold Mining Co Ltd* 1969 3 SA 629 (A) 663*; Tenowitz v Tenny Investments (Pty) Ltd* 1979 2 SA 680 (E) 683.
2 GN 1183 in *Government Gazette* 26493 of 2004-06-08.
3 Available at http://bit.ly/2BqEDzX (accessed on 15 February 2016).
4 *Ibid.*
5 Alberts *Business rescue in South Africa: A critical review of the regulatory environment* (MBA dissertation 2010 UP) 10.
6 In terms of chapter 6 of the Companies Act 71 of 2008.
7 Hereafter referred to as "Companies Act of 2008", "the 2008 Companies Act" or "the Act".
8 Section 133.

laying tactic, especially because it is a relatively simple process for any company to go into business rescue by filing a resolution by its board.[9]

The Companies Act of 2008 attempts to prevent abuse by way of section 129(1)(b) which provides that business rescue is only available to a company if there is a reasonable prospect that the company can be rescued through the business rescue proceedings. This means that should a debtor attempt to abuse the process of business rescue, any affected person[10] will be able to bring an application to court to set the business rescue aside.

### 1 2 Problem statement and research objective

This study examines the requirements to commence business rescue and how it is – and should – be applied against the backdrop of the former process of judicial management. Are our courts applying the concept correctly or is the concept applied too strictly as a result of the legacy of judicial management? There should be a proper balance in the application of the requirements to prevent the abuse of business rescue proceedings, whilst not being too strict and cause business rescue proceedings to fall into disuse, as they are essential to achieve the purpose of the Companies Act of 2008 as set out in section 7 thereof. Section 7(k) provides that one of the purposes of the Act is to provide for the efficient rescue and recovery of financially distressed companies in a manner that balances the rights and interests of all relevant stakeholders.

This might prove to be very difficult as employees, creditors and shareholders may pull in different directions. One may assume that, in almost every case, the employees will be in favour of business rescue as they will lose their livelihood should the company be placed in liquidation. Shareholders of a company are also likely to favour business rescue because, should the company go into liquidation, they will only receive their share capital after all the company's creditors have been paid. Creditors, on the other hand, may be opposed to business rescue proceedings being insti-

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9 Section 129.

10 In terms of section 128 an "affected person", in relation to a company, means a shareholder or a creditor of a company, any registered trade union representing employees of the company and if any of the employees of the company are not represented by a registered trade union, each of those employees or their respective representatives.

tuted as the moratorium will prevent them from instituting proceedings to retrieve whatever they are owed by the company, and should the business rescue not succeed, the company's resources would have been depleted further as a result of the costs of business rescue, leaving less for the creditors should the company then be liquidated. Another factor to be considered is the fact that a company is an important part of a community, and therefore of a country. In an economy such as ours with a currency sinking ever lower against the dollar and the pound, and with a very high unemployment rate and poverty, we cannot afford business rescue to fall into disuse as it has a direct impact on the economic and social wellbeing of a community through its employees, suppliers and distributors.[11]

## 1 3 Scope of study

The concept and principles of business rescue present a vast area of research possibilities, especially since it is a relatively new process and there many divergent opinions regarding specific sections and possible shortcomings of the business rescue provisions in the 2008 Companies Act. Therefore, there is a danger of casting the net too wide. New developments up to the end of June 2017 have been considered for purposes of this study.

The aim of the dissertation's is not to explore the new Act and the whole of Chapter 6, but rather to explore and focus on the requirements to commence business rescue in terms of Chapter 6, and to focus on those areas that have proven to be problematic considering the past years' outcomes. One of these requirements is the concept of "reasonable prospect". It is submitted that this is a key provision for determining whether a business rescue may be viable.

## 1 4 Methodology

This study comprises of five chapters. The specific outcomes of each chapter are as follows:

[11] Loubser *Some corporate aspects of corporate rescue in South African company law* (LLD thesis 2010 UNISA) 1 (hereafter referred to as Loubser).

Chapter one introduces the topic and gives a general introduction of business rescue. It explains the research question and concludes with certain concepts regularly used in this study. While it is not the aim of this study to discuss judicial management in depth, a brief overview of its requirements is given in chapter two, with specific reference to the problems that were encountered and an examination of why it did not succeed. Identifying the problems that occurred with judicial management is useful to determine whether the Companies Act of 2008 has overcome those problems by introducing the business rescue process. Chapter three contains the definition,[12] processes[13] and requirements of business rescue, with emphasis on the burden of proof and the concept of "reasonable prospect". Chapter four contains a summary of recent case law and how the courts interpreted and applied the various requirements, especially the concept of "reasonable prospect". Chapter five concludes the study.

## 1 5 Concepts and terminology

The following definitions and terminology are used throughout the dissertation. The definitions are derived from both the Companies Act 61 of 1973 and the Companies Act of 2008.

**Companies Act of 1973** refers to the Companies Act 61 of 1973.

**Companies Act of 1926** refers to the Companies Act 46 of 1926.

**Chapter 6** refers to Chapter 6 of the Companies Act 71 of 2008.

**Affected person** means a shareholder or a creditor of a company, any registered trade union representing employees of the company and 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]

**CIPC** refers to the Companies and Intellectual Property Commission of South Africa.

**The Master** refers to the Master of the High Court of South Africa.

**The High Court** refers to the High Court of South Africa.

[12] Section 128(1)(b) of the 2008 Companies Act.
[13] Sections 129 and 131.
[14] Section 128(1)(a).

# CHAPTER 2
# BACKGROUND TO THE DEVELOPMENT OF SOUTH AFRICAN RESCUE PROCEDURES

## 2 1 Introduction

The purpose of this chapter is to assess the position in the South African law prior to the introduction of business rescue in terms of the Companies Act of 2008. As noted by the comments in Parliament,[15] judicial management qualified as a corporate rescue procedure and is therefore relevant to this discussion.[16]

The assessment seeks to identify the reason why there was a need to introduce a new business rescue regime by examining the procedure and requirements of judicial management.

The remedy of judicial management was originally introduced into South African law under the Companies Act of 1926[17] and retained in the Companies Act of 1973[18] with the hope of restoring companies in financial distress to successful concerns. When the Bill was first introduced into Parliament in 1923 the Minister of Justice made the following comments:

> "Powers of that kind would be used sparingly by the courts. To take a hypothetical case, you might have a large wool factory getting into difficulties and which ought to be helped because it is an institution which helps the country. Then your court could intervene, when it is shown that this concern is solvent, and thus help it through its difficulties . . . [I]t might be used to save a concern, and it is for such sparing use that it has been inserted in the bill. The concerns you would like to help with this power are industrial concerns such as factories manufacturing articles in South Africa."[19]

These remarks make it clear that judicial management was to be applied only in very limited circumstances with the object of protecting a vital industry.[20] In practice this initial objective of aiding only vital industries was overlooked and judicial manage-

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15 Hansard *House of Assembly Debates* 6 1926-02-25 col 996-997.
16 Rajak and Henning "Business rescue for SA" 1999 *SALJ* 262.
17 Sections 195 to 198.
18 Sections 427 to 440.
19 Hansard *House of Assembly Debates* 6 1926-02-25 col 996-997.
20 Olver "Judicial management – A case for law reform" 1986 *THRHR* 84.

ment was applied to any company of any size provided that the court was satisfied that there was a probability that the company would overcome its difficulties.[21]

This remedy, however, proved unpopular and of little use and many companies that could have been saved were placed under liquidation. In theory, judicial management offered the prospect that a company which had become financially distressed could return to viability if put under the control of an expert judicial manager. In practice, however, placing a company under judicial management almost always proved to be fatal as it affected the financial reliability of the company. The company's reputation in the market place was irreparably damaged, it was considered a lost cause and very few entities and/or people were prepared to do business with it.

### 2 2 Judicial management in terms of the Companies Act of 1973

Section 427 of the 1973 Companies Act provided that where there was a reasonable probability that, if a company is placed under judicial management, it will be enabled to pay its debts or meet its obligations and become a successful concern, the court may[22] if it is just and equitable, grant a judicial management order in respect of that company.[23] The purpose of judicial management therefore was to enable companies that were suffering a temporary setback due to mismanagement or other special circumstances to become successful concerns once again.[24]

#### 2 2 1 Provisional judicial management order

The judicial management process was commenced by an interested party[25] applying to court to have the company placed under judicial management. If the application

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21 *Ibid*.

22 The court maintained a discretion as seen in *Maynard v Office Appliances (Pty) Ltd* 1929 WLD 290, where the court rejected the application for the appointment of a judicial manager based on the allegation that there had been mismanagement in the conduct of the company's affairs and pointed out that the financial situation of the company can be dealt with by reducing the cost of management and increasing the capital of the company which can subsequently be dealt with by the directorship of the company.

23 Burdette "Some initial thoughts on the development of a modern and effective business rescue model of South Africa (Part 1)" 2004 *SA Merc LJ* 248.

24 *Silverman supra* note 1 350.

25 Section 427(2) of the Companies Act of 1973. There was no differentiation between persons who could apply for the winding-up or judicial management of a company. Persons who may have applied were described in section 346 to be the ailing company, one or more creditors (including contingent or prospective creditors) and members referred to in section 103(3) irrespective of whether they had been registered as members of that company. Provisional and final liquidators have also been allowed to apply for judicial management although there was no statutory provision for it. See

*continued on next page*

was successful the court would grant a provisional judicial management order, after which the Master would appoint a provisional judicial manager who would take over the management and control of the assets of the company, thus removing the company from the control of its directors.[26] Only liquidators could be appointed as judicial managers.

A court could, in its order, suspend all legal processes against the company[27] but could also consent to the continuation of the processes.[28] The moratorium afforded the company the opportunity to operate without pressure from creditors, thereby allowing it some "breathing space" to re-organise itself. The provisional order provided for the directions, provisions[29] and specified period[30] of the moratorium. In *Transkei Development Corporation Ltd v Oshkosh Africa (Pty) Ltd*[31] it was held that no *concursus creditorum* was created by a judicial management order, which as a result created an automatic "set-off" between the debts incurred before and those incurred after judicial management even if the order provided for a moratorium.[32] Although the likelihood of judicial management succeeding without a moratorium was extremely low,[33] a court always had discretion whether or not to grant the moratorium.

The provisional judicial manager's main duty was to prepare a report for submission at the various meetings. The report had to contain the status of the affairs of the company, the reasons for the company's inability to pay its debts, the assets and liabilities of the company, a list of the creditors' outstanding amounts and the nature of their claims, the sources from where money would be obtained and the judicial manager's opinion as to the prospects of the company.

At the meeting of creditors, members and debenture holders, the desirability to place the company in final judicial management was considered, a final judicial manager

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*Common Fund Investment Society Ltd v COC Trust Co Ltd* 1968 4 SA 137 (C).

26 Section 430(a) of the 1973 Companies Act.

27 This is known as a moratorium.

28 Section 428(2).

29 Section 427.

30 Section 428.

31 1966 3 SA 344 (W).

32 Loubser 32.

33 *Ibid*.

was nominated and creditors proved their claims. Although the fact that the application went to court twice gave the creditors the opportunity to decide or recommend that the company be placed under final judicial management, this caused the process to be lengthy and very costly which was not ideal as the company was already distressed. A meeting could also be convened for the purpose of deciding on the subordination of claims in order to rank claims that arose during judicial management before those that arose prior to the order.[34] The return date for the final order had to be within 60 days after the provisional order was granted but the court could grant a longer period if a good reason existed for doing so.

### 2 2 2 Final judicial management order

On the return day of the provisional judicial management order, the court had to consider the opinions of the members, judicial manager, the Master and registrar of companies' report and decide whether a final judicial management order were to be granted. When a final judicial management order was granted the court replaced the directors of the company with a manager who continued to run the company's business, under the supervision of the Master, with the aim of restoring the company to being a successful concern. Surplus funds available were divided amongst the creditors and if the company was unable to pay its debts, application could be made to court to set aside any voidable transactions. Once the company was under final judicial management, the court could not grant leave that any action, proceeding or execution against the company could be proceeded with.[35]

According to Kloppers,[36] the requirement of a court order for both provisional and final judicial management was a legacy of indecisiveness stemming from the adversarial nature of our courts and the role of the judge as a neutral adjudicator without any prior knowledge of the issues arising for decision. Josman J[37] pointed out that

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[34] Section 435(1)(a) of the Companies Act of 1973. According to *Chemical Workers Industrial Union v The Master* 1997 2 SA 442 (E), section 435(1)(b) applies to the obligation to pay wages in terms of contracts concluded prior to the judicial management for services rendered during the course of judicial management.

[35] *Wire Industries Steel Products and Engineering Ltd v Surtees and Heath* 1953 2 SA 531 (A).

[36] Kloppers "Judicial management reform – Steps to initiate a business rescue" 2001 *SA Merc LJ* 373.

[37] In *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd (FBC Fidelity Bank Ltd (under curatorship) intervening)* 2001 2 SA 727 (C) 747 par 73 and 74.

the adversarial process was not ideally suited to applications for judicial management orders and that negotiation between the parties would have been a better option than engaging in court processes.

In time, the judicial manager had to apply either for the cancellation of the judicial management order or for the winding-up of the company. There were, however, no time frames set in which either of these were to be accomplished.

### 2 3 Initiating requirements for judicial management

The basic requirements to commence judicial management were set out in section 427(1) of the Companies Act of 1973 which provided as follows:

> "427. Circumstances in which company may be placed under judicial management.
> (1) 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."[38]

Subsection (1)(a) and (b) related to the state the company found itself in, and must have been proved for an applicant to have *locus standi* to obtain a judicial management order.[39] Before the court would grant an order it also had to be proved that there was a reasonable probability that the company would be able to meet its obligations and become a successful concern and that it would be just and equitable to grant such an order.

#### 2 3 1 Inability to pay debts or meet obligations

The first specific requirement for a judicial management order was that a company must have been unable to pay its debts or probably unable to meet its obligations.[40] The expression "unable to pay its debts" is found in a number of other sections of the 1973 Companies Act, namely, sections 339, 345, 360(1), 366(1)(c), 386(4)(d),

[38] Own emphasis.
[39] Burdette 2004 *SA Merc LJ* 248.
[40] Section 427(1)(a) of the Companies Act of 1973.

414(1), 415(1) and 416(1)(a). Olver[41] is of the opinion that its meaning in section 427 was the same as that in section 345 but since there was no provision that defined when a company would be deemed unable to pay its debts for purposes of judicial management,[42] commercial insolvency had to be proved.

A company may be technically solvent in the sense that its assets exceed its liabilities, but commercially insolvent in the sense that its assets are not easily realisable and therefore its liquidity is such that it cannot meet its day-to-day expenses. In *Rosenbach & Co (Pty) Ltd v Singh's Bazaar's (Pty) Ltd*,[43] Caney J said:

> "[I]f it is established that a company is unable to pay its debts, in the sense of being unable to meet the current demands upon it, its day to day liabilities in the ordinary course of business, it is in a state of commercial insolvency; that it is unable to pay its debts may be established by the means provided in para (a) or para (b) of s 112 (now section 345) or in any other way by proper evidence. If the company is in fact solvent, in the sense of its assets exceeding its liabilities, this may or may not, depending upon the circumstances, lead to a refusal of a winding up order; the circumstances particularly to be taken into consideration against the making of an order are such as show that there are liquid assets or readily realisable assets available out of which, or the proceeds of which, the company is in fact able to pay its debts."

Kloppers[44] argued that insolvency or pending insolvency should not be a requirement as the earlier a company recognises that it should reorganise itself because of looming financial disaster, the better the chances of avoiding eventual liquidation and the greater the possibility of successful reorganisation. This requirement resulted in a substantially reduced chance of the company being successfully rescued. It is obvious and generally accepted that if remedial action is taken at an early stage of a company's financial problems, preferably before the company has become insolvent

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41 Olver *Judicial management in South Africa. It's origin, development and present day practice and a comparison with the Australian system of official management* (LLD thesis 1980 UCT) 49 (hereafter referred to as Olver).

42 There are different opinions on whether section 345, which describes these circumstances for the purposes of an application for winding-up of a company, was applicable to judicial management. In this regard, see Olver 1986 *THRHR* 84 and Loubser 21.

43 1962 4 SA 593 (D) 597.

44 Kloppers 2001 *SA Merc LJ* 376.

or unable to pay its debts, the company has a considerably better chance of surviving.[45]

It is submitted that "inability to meet its obligations" is not the same as being unable to pay its debts. A company may be able to pay its current debts but it may foresee that it will not be able to meet its obligations in future.[46] These obligations need not necessarily be the payment of debts but can be any other obligation such as the fulfilment of a contract.[47]

### 2 3 2 Not a successful concern

The Companies Act of 1973 did not indicate under which circumstances a company would be regarded as not being a successful concern. Loubser[48] described this requirement as vague and an unnecessary addition to the very difficult requirements that already had to be met for obtaining a judicial management order. She further argued that it was unnecessary as a company that was unable to pay its debts or meet its obligations very obviously was not a successful concern.

### 2 3 3 Reasonable probability

A rather heavy burden of proof rested on the applicant as a result of the requirement that the court had to be satisfied that a reasonable probability existed that the company would be enabled to pay its debts or meet its obligations and become a successful concern if placed under judicial management.

In one of the first reported cases[49] to consider the judicial management sections of the 1926 Companies Act, De Wet J considered the important features to be that there was an *onus* on the applicant to show a reasonable probability that, if the company were to be placed under judicial management, it would be able to meet its obligations, thereby removing the need for liquidation. He required not only a reasonable probability but a strong probability and said the following:[50]

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45 Loubser 22.
46 Olver 49.
47 *Idem* 50.
48 Loubser 22.
49 *Silverman supra* note 1 349.
50 *Idem* 353.

> "It seems to me that the object of the section is to obviate a company being placed in liquidation if there is some strong probability that by proper management or by proper conservation of its resources it may be able to surmount its difficulties and carry on."

It was difficult for the court to decide whether or not the company had a reasonable probability of becoming a successful concern because the court was often not in possession of sufficient evidence. Accordingly, the Companies Act 23 of 1939 introduced a new section 195(4) which allowed the court to refer any application to the Master for investigation and a report before granting the application.[51]

Van Blerk AJ[52] did not require a strong probability and rather required a reasonable probability and not merely a reasonable possibility. He held that the difference between the words "possible" and "probable" was material and stated that in legal terminology something that is possible is less sure to happen than something that is probable.

In *Kotze v Tulryk Bpk*[53] it was held that although a reasonable probability must exist, it was going too far to say that this must be a strong probability. In *Tenowitz*,[54] however, it was held that a strong probability must exist when granting a final order on the return day and a reasonable probability applies at the stage when the provisional judicial management order is sought. The court in *Ex Parte Onus (Edms) Bpk; Du Plooy v Onus (Edms) Bpk*[55] was of the opinion that the test for a provisional and final order was exactly the same and found no support in the wording of the 1973 Companies Act to support a more stringent test for a final order.

De Villiers J in *Weinberg v Modern Motors (Cape Town) (Pty) Ltd*[56] stated the following in respect of a case requiring an applicant to show a reasonable probability of success: "This amounts to a finding of fact based on the evidence before it. A mere confident hope expressed in affidavits and not sufficiently supported by concrete evidence is not enough."

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51 Olver 31.
52 *Noordkaap Lewendhawe Ko-operasie Bpk v Schreuder* 1974 3 SA 102 (A) 110.
53 1977 3 SA 118 (T) 239.
54 *Supra* note 1 684.
55 1980 4 SA 63 (O) 66C-D.
56 1954 3 SA 998 (C) 1001.

Some of the factors that were taken into account by Josman J,[57] to determine whether the onus to prove a reasonable probability had been discharged, were the reasons for the lack of success of the company,[58] problems relating to the management of the company, which he stated could be in the applicant's favour as mismanagement could be something that could be "put right",[59] other competition in the industry[60] and the period of time that the applicant would have to be under judicial management.[61]

Some other factors that the courts have considered when determining reasonable probability of success were the availability of credit facilities,[62] the availability and cost of acquiring the right technical skills[63] and the fact that the paid-up share capital of a company has been lost.[64]

Kloppers[65] criticised this requirement as being outdated, unrealistic and often contrary to the wishes of creditors. Burdette[66] submitted that the burden of proof was too onerous and that the test should rather have been one of "reasonable possibility".[67] This requirement, in his opinion, was one of the reasons why judicial management could not be successfully implemented in South Africa.

### 2 3 4 Able to pay its debts, meet its obligations and become a successful concern

Claassen J[68] stated that one of the main reasons why judicial management fell into disuse was the requirement that creditors' claims were to be paid "in full". A consid-

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57 *Le Roux Hotel Management supra* note 37 727.
58 *Idem* 745 par 66.
59 *Idem* 745 par 67.
60 *Idem* 745 par 68.
61 *Idem* 746 par 70.
62 Olver 42.
63 *Idem* 43.
64 See *Irvin and Johnson Ltd v Oelofse Fisheries Ltd; Oelofse v Irvin and Johnson Ltd* 1954 1 SA 231 (E)*; De Jager v Karoo Koeldranke en Roomys (Edms) Bpk* 1956 3 SA 594 (C) 602C.
65 Kloppers 2001 *SA Merc LJ* 363.
66 Burdette 2004 *SA Merc LJ* 249.
67 See also Burdette "Unified insolvency legislation in South Africa: Obstacles in the path of the unification process" 1999 *De Jure* 44 57.
68 *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* 2012 3 SA 273 (GSJ) 274 par 17.

eration that, under such an order, it would have been possible at a later stage to wind up a company more advantageously for creditors carried no weight.[69] It was immaterial that the business of a company might have been disposed of on more favourable terms if it was offered for sale as a going concern under judicial management, as opposed to the lesser proceeds which might have been obtained from the piecemeal sale of assets.[70]

Judicial management was not to be instituted or continued as an alternative method of liquidation[71] and it should not have been initiated or continued merely on the basis that, while it subsisted, the company's assets might be sold more advantageously.[72] In *Millman*,[73] Baker AJ stated:

> "The essential thing which an applicant for a judicial management order must establish, at least *prima facie* at the initial stage, is the prospect of ensuring the company's viability; and from this viability flows the prospect of ultimate solvency. But if ultimate solvency is not in fact expected by the applicant for an order, he is not entitled to ask the Court to prolong the existence of the company."

Kloppers[74] criticised the requirement and was of the opinion that in the prevalent credit economies of the time, it was widely accepted that creditors would usually have accepted a reduction of their claims and rather have reaped the longer term benefits of having a viable debtor with which to do business. Rajak[75] argued that this requirement was outdated, unrealistic and often contrary to the wishes of creditors who would have preferred a future supplier or purchaser of their products.

If the company was not required to become a successful concern it would be possible for a company to obtain a moratorium by way of judicial management, finish its existing contracts (thus meeting its obligations), generate sufficient money to repay

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69 *Marais v Leighwood Hospitals (Pty) Ltd* 1950 3 SA 567 (C); *Millman v Swartland Huis Meubileerders (Edms) Bpk* 1972 1 SA 741 (C).
70 Cilliers *et al Corporate Law* (2000) 478; *Irvin and Johnson Ltd supra* note 64 231; *Millman supra* note 69 741; *Tenowitz supra* note 1 684.
71 *Supra* note 69 741.
72 Meskin *et al Henochsberg on The Companies Act* (1975) 760; *Millman supra* note 69 743.
73 *Supra* note 69 744.
74 Kloppers 2001 *SA Merc LJ* 363.
75 Rajak and Henning 1999 *SALJ* 268.

its creditors (thus removing the occasion for liquidation), and then, because of a lack of credit facilities, cease to operate.[76]

### 2 3 5 Just and equitable

After satisfying the court that there was a reasonable probability that the company would recover, the court still had to consider whether it would be just and equitable to grant an order for judicial management.[77]

In determining whether it would be just and equitable to grant a judicial management order, a court had to take into account the interests of the creditors, the target company and the applicants.[78] The interests and wishes of the creditors played an important role in determining whether an order would be just and equitable as can be seen in *De Jager*[79] where Rosenow AJ said:

> "As a matter of fact, it is difficult to see how it could ever be just and equitable to grant a postponement, against the wishes of a creditor, unless the Court is persuaded that it would probably be in the interest not only of such creditor himself, but also of other creditors and of the shareholders to grant such a postponement."

Reynolds J in *Irvin and Johnson Ltd*[80] conceded that the courts did have the power to affect the rights of a creditor, but qualified it by saying that such action had to be completely warranted on the particular facts of a case and that it was unlikely to be exercised against a creditor demanding immediate payment, who best knew whether liquidation or judicial management was in his interest. However, the position of the creditor has never been the sole ground for a court to refuse an order and there has always been some additional factor, like the prospect of a long moratorium taken together with other doubt-raising factors, to induce the court to refuse the order.[81] The reasons for the company's financial difficulties would probably also have had to be considered when deciding whether it was just and equitable to grant the order.[82]

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76 Olver 44.
77 *Le Roux Hotel Management supra* note 37 745 par 63.
78 *Idem* 741 par 47.
79 *Supra* note 64 602C.
80 *Supra* note 64 231E.
81 *Millman supra* note 69 747D.
82 Loubser 21; *Ex parte Onus supra* note 55 66; *Portestraat 69 Eiendomme (Pty) Ltd v PA Venter Worcester (Pty) Ltd* 2000 4 SA 598 (C) 615.

In *Le Roux Hotel Management*,[83] where the major creditor found itself in financial trouble, it was held that a cash-strapped creditor should not be required to worsen its position by allowing a moratorium to a defaulting debtor, and that it would not be just and equitable to grant a judicial management order where the intervening creditor was also in a precarious financial situation.[84]

According to Olver[85] the size of a company should also play a role in whether it would be just and equitable to place the company into judicial management. He submits that too many orders of judicial management were granted in respect of small companies and that the courts should follow *Tobacco Auctioneers Ltd v AW Hamilton (Pty) Ltd*[86] where Golden J said the following in respect of small companies and what should be considered:[87]

> "Doubt has been expressed in several cases whether in law judicial management proceedings are really intended to apply to a small company. In my respectful view the fact that a company is a private company with no more than two or three members or even with a few issued shares, is not in itself sufficient reason for holding that section 262 does not apply to it or is not an appropriate form of relief. The extent and scope of the business activities of a company, its assets and liabilities and the nature of its difficulties are all relevant factors in deciding whether section 265 is applicable."

Olver[88] further submits that the effect on the economy or community should be considered and that the mere fact that a few creditors may benefit should not be the criterion, as creditors in the nature of their business expect to take commercial risks.

The time it would take for the company to meet its obligations was a relevant consideration when determining whether judicial management would be just and equitable.[89] It was not just and equitable to grant the order merely to resolve domestic differences between management.[90]

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83 *Supra* note 37 744 par 60.
84 *Le Roux Hotel Management supra* note 37 746 par 72.
85 Olver 1986 *THRHR* 88.
86 1966 2 SA 451 (R).
87 *Idem* 453.
88 Olver 1986 *THRHR* 88.
89 *Tenowitz supra* note 1 680.
90 *Makhuva v Lukoto Bus Service (Pty) Limited* 1987 3 SA 376 (V).

## 2 4 Possible reasons for judicial management being unsuccessful as a rescue mechanism

### 2 4 1 General and miscellaneous difficulties

Judicial management has been criticised by various writers and the need for a change in our corporate insolvency law has been propagated since the late 1980s.[91] Judicial management has been described as a "spectacular failure",[92] "an abject failure"[93] and recently as a "cumbersome and ineffective procedure".[94] Josman J called it "a system which has barely worked since its initiation in 1926".[95]

The failure of judicial management can be attributed to, amongst others, the burden of proof of "reasonable probability" being too high, court proceedings being very costly and time consuming and judges not necessarily having the expertise and seeing it as "extra ordinary". Directors were automatically replaced, even though mismanagement was not always the cause of the financial distress, causing the only persons who really had insight into the business no longer to be involved. There was no statutory provision for the development of a formal rescue plan which sometimes led to abuse as the judicial manager was not under any pressure to complete his tasks while still receiving remuneration.[96]

Olver[97] believed that there were three basic reasons for the limited success of judicial management. Firstly, judicial management was seen as an adjunct to liquidation, seeing that it was at the end of the chapter of winding-up in the 1926 Companies Act. The association with liquidation led to professional liquidators being appointed as judicial managers, whereas the duties and objectives of the two are very different.

Secondly, Olver believed it was more palatable for a businessman to accept judicial management than liquidation and that he would often be persuaded by his advisers

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91 See Smits "Corporate Administration: A Proposed Model" 1999 *De Jure* 80.
92 *Idem* 85.
93 See Stein and Everingham *The new Companies Act unlocked* (2011) 409.
94 *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* 2012 2 SA 423 (WCC) par 20. See Joubert "'Reasonable possibility' versus 'reasonable prospect': Did business rescue succeed in creating a better test than judicial management?" 2013 *THRHR* 550 551.
95 *Le Roux Hotel Management supra* note 37 744 par 60.
96 Loubser 41.
97 Olver 1986 *THRHR* 86.

to adopt the judicial management route. As liquidators often came on the scene before the application was made to court they were more likely to secure the co-operation of the businessman by suggesting judicial management rather than liquidation. Once the judicial manager had been appointed it did not matter if it was found that the company should be liquidated as the judicial manager was invariably appointed as the liquidator. The fees for liquidation were often much higher than fees for judicial management which could result in a conflict of interest. A liquidator's duties included a duty to expose offences which occurred prior to liquidation which would include the judicial management period and thus the liquidator would be reporting on his own administration.

Thirdly, there were a large number of trivial or frivolous applications for judicial management. A large proportion of the companies placed under judicial management were small private companies whose demise had little or no effect on the economy of the country.[98] According to Olver, judicial management was introduced to protect a large public company employing a large labour force and whose liquidation would have an adverse effect on the economy and the community. The courts have also expressed their doubts as to whether judicial management was a suitable remedy for small companies.[99]

### 2 4 2 Strict application by the courts

The South African courts saw judicial management as an extraordinary measure[100] since a creditor of a company that was unable to pay its debts was primarily entitled to liquidation as a means of recovering a debt.[101] Smalberger J[102] held that since a creditor of a company that was unable to pay its debts had a right *ex debito justitiae* to liquidate the company, an order for the judicial management of that company should be regarded as a special or extraordinary remedy, and not as an experiment to determine whether a company could extricate itself from its financial difficulties.

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98 *Idem* 87.

99 See *Silverman supra* note 1 353; *Weinberg supra* note 56 1000; *Ronaasen v Ronaasen & Morgan (Pty) Ltd* 1935 CPD 562 563; *Rustomjee v Rustomjee (Pty) Ltd* 1960 2 SA 753 (D) 758.

100 Silverman *supra* note 1 353 which view was supported in *Sammel supra* note 1 663 and followed in *Tenowitz supra* note 1 685.

101 Kloppers 2001 *SA Merc LJ* 362.

102 *Tenowitz supra* note 1 685.

De Wet J[103] stated that judicial management was a "special privilege" only to be authorised in very "special circumstances". Olver[104] agreed and suggested that the legislature should amend the Act to make it clear that it was a "special privilege only to be granted in special circumstances" and that the debates in 1923 and 1926 clearly show that this was the intention of the legislature at the time.

However, Josman J[105] criticised the conservatism of the courts in granting judicial management orders and stated the following:

> "For me, sitting as a Judge trying to regenerate a system which has barely worked since its initiation in 1926, would not only be inappropriate but would also require me to disregard the body of precedent that has been established incorporating a very conservative approach to judicial management."

He further noted that it was unfortunate, in light of recent developments at the time, that the progressive initiative taken in South Africa in 1926 did not follow a different course.[106] Since the 1973 Companies Act was left to judicial interpretation, the inherent conservatism of the courts, especially at that stage, ensured that a restrictive interpretation rather than a purposive and progressive one would be applied in developing the culture of corporate rescue.[107]

Kloppers,[108] although he was of the view that there was nothing in the South African legislation itself that merited the requirement that judicial management be treated as an extraordinary measure, conceded that in light of past decisions it would be difficult for the courts to treat judicial management as being an appropriate alternative to liquidation and that it would probably need a change in legislation.

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103 *Silverman supra* note 1 353.
104 Olver 1986 *THRHR* 88.
105 *Le Roux Hotel Management supra* note 37 740 par 60.
106 *Idem* 738 par 39.
107 *Ibid*.
108 Kloppers "Judicial management – A corporate rescue mechanism in need of reform" 1999 *Stell LR* 417.

### 2 4 3 Creditors' attitudes and "rescue culture"

Josman J[109] acknowledged that the economically developed countries, being the United States, Australia, United Kingdom and Canada, had appreciated business rescue as an important feature of company law, but added that the success of those economies might have been linked to the progressive attitude adopted towards assisting an enterprise that encounters difficulties which are capable of being overcome. In South Africa, banks could be rather merciless in their attempts to recover their loans and there was a need for banks to change their attitude towards corporate rescue procedures.[110]

A country's "rescue culture" plays a big role in the successful application of a corporate rescue mechanism in that country. A corporate rescue regime has a far better chance of succeeding if the insolvency system in which it is applied is debtor-friendly as opposed to creditor-friendly.[111] South Africa has a creditor-friendly insolvency system and it is submitted that the fact that the courts took a very conservative approach to judicial management was a contributing factor in the failure of judicial management. South Africa focused more on the interests of the insolvent and its creditors and did not necessarily pay much attention to the effect it had on the society and economy of the country.[112] Josman J[113] stated that if a business rescue regime is to be enacted in South Africa, the special requirements of the South African economy would have to be considered, which would require legislative intervention.

## 2 5 Conclusion

This chapter dealt with the various requirements to commence judicial management, as well as the difficulties encountered in respect thereof. The 1973 Companies Act provided for only one set of requirements, irrespective of who brought the application.

In order to apply for judicial management the company had to be unable to pay its debts, and it is submitted that by that stage, it was probably already too late to res-

109 *Le Roux Hotel Management supra* note 37 744.
110 Kloppers 2001 *SA Merc LJ* 363.
111 Harmer "Comparison of trends in national law: The Pacific Rim" 1997 *Brook J of Int'l L* 139 147.
112 *Ibid*.
113 *Le Roux Hotel Management supra* note 37 745.

cue the company. The earlier a company recognises that it should reorganise itself the better its chances of avoiding liquidation.[114] Another requirement was that the company was not a successful concern, which was vague and redundant, as a company that was unable to pay its debts was clearly also not a successful concern.

The fact that a reasonable probability of rescuing the company had to be proved, meant that a rather heavy, and probably too onerous, burden of proof rested on the applicant. Creditors' claims were to be paid in full and a consideration that it would have been possible at a later stage to wind up a company more advantageously for creditors carried no weight. These requirements were outdated, unrealistic and often contrary to the wishes of creditors.[115] It is submitted that these requirements were one of the main reasons for judicial management being unsuccessful.

Commencing judicial management was only possible through an order of court which proved to be very costly and time consuming. The requirement that the applicant had to prove that it would be just and equitable to grant a judicial management order caused this process to be seen as an extra-ordinary remedy. Judicial management was seen as "creditor friendly" as it was unlikely that an order would be granted against a creditor who demanded immediate payment.[116]

In South Africa not enough attention had been paid to the rehabilitation of a corporate entity in financial distress, which was necessary in South Africa's economic climate. The country has always had a very creditor-friendly culture and with the creditors' attitudes and the courts' strict application of judicial management it was always destined to fail. There was no balance between the interests of the company's employees and society as a whole on the one hand, and the insolvent and creditors on the other, which meant that the effect on the society and economy was seldom considered. The requirements to commence judicial management were too strict and there was too much focus on creditors.

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114 See chapter 2 par 2 3 1.
115 See chapter 2 par 2 3 3.
116 See chapter 2 par 2 3 5.

The new business rescue provisions in the Companies Act of 2008, discussed in the following chapter, have thus replaced the judicial management provisions of the repealed[117] Companies Act of 1973. Judicial management was a good stepping stone in that all its shortcomings have been exposed but whether all the flaws were successfully dealt with and improved on in the new Act will be investigated and discussed in the chapters to follow. In the next chapter the business rescue provisions and more specifically the requirements to commence business rescue are discussed, which should be indicative of whether business rescue has improved on and provided South Africa with a more effective alternative to liquidation.

[117] Except for chapter 14 which deals with the winding-up of a company.

# CHAPTER 3
# ASPECTS OF BUSINESS RESCUE PROCEEDINGS IN TERMS OF THE 2008 COMPANIES ACT

## 3 1 Introduction

The business rescue provisions[118] were one of the most eagerly awaited innovations of the Companies Act of 2008. These provisions replaced the judicial management provisions of the Companies Act of 1973 which, it is generally agreed, had seldom yielded positive results.[119]

Various factors may give rise to the failure of a company, such as factors within the company's operational sphere, national or international demand for a particular product, poor marketing strategies or poor management of the company by its office bearers.[120] The failure of a company affects not only its shareholders and creditors, but also its employees, suppliers, distributors and customers, which means that if a large company in an area collapses whole communities could experience serious socio-economic problems.[121] It is for this reason that it is important to attempt to rescue a company or a business which has the potential to survive and overcome its financial difficulties if given some breathing space.

The 2008 Companies Act introduced a new business rescue procedure aimed at facilitating the rehabilitation of companies that are financially distressed. The procedure broadly involves the temporary supervision of a company and a temporary moratorium on the rights of claimants against the company or against property in the company's possession while a plan to rehabilitate the company is approved and implemented.

It should, however, be kept in mind that a natural consequence of any market-based economy is that some companies will fail and that this is not necessarily a bad thing.

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118 Chapter 6 of the 2008 Companies Act.

119 Empirical studies indicated a success rate of between 15% and 20%. See Smits 1999 *De Jure* 86.

120 Davis *et al Companies and other Business Structures* in South Africa (2013) 235 (hereafter referred to as Davis *et al*).

121 *Idem* 236.

Most industrialised nations recognise that failed companies are part of a healthy economy in that if companies cannot be competitive in the marketplace, they should be taken over by other stronger companies or wound up.[122] It is for this reason that the business rescue process should not be abused, as in some cases it would be a natural and necessary consequence if a company is liquidated – providing a healthy market where companies have competition to provide good products and services to consumers. Placing a company into business rescue, knowing that there is no potential to rescue it, will result in the disrepute of the process, as was the case with judicial management, which will only have a negative impact on those companies that in fact can be rescued.

This chapter deals with business rescue proceedings, and more specifically with the requirements to commence with the proceedings. An attempt is made to determine whether the requirements are too strict or whether there is a balance, in that the requirements balance the rights of all stakeholders by not making commencement too difficult while also preventing abuse of the process.

Background information, some of which was also discussed in chapter two, is provided, which is relevant for a comprehensive understanding of some of the difficulties that are still being experienced and to ascertain how far we have come in establishing a proper rescue process.

### 3 2 Definition, purpose and other aspects of business rescue

Business rescue is defined in section 128(1)(b) of the Companies Act of 2008 as proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for:

"(i) the temporary supervision[123] of the company, and 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

[122] *Idem* 235.
[123] Defined in section 128(1)(j) as the oversight imposed on a company during its business rescue proceedings.

(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 maximizes 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."

Although the purpose of business rescue proceedings is stated as being "proceedings to facilitate the rehabilitation of a company", the term "rehabilitation" is not defined in the Act.[124] This is unfortunate as the interpretation of rehabilitation, as contained in both the 1926 and 1973 Companies Act, was problematic. Rehabilitation would normally mean restoring the company to solvency, similar to the judicial management provisions, but this can be misleading as provision is also made for a situation, where the ultimate rescue of the company is not possible, that another outcome ensuring a higher return for creditors than they would have received under liquidation is also acceptable.[125] Although this seems to create a contradiction within the definition, it is submitted by Meskin[126] that the alternative objective, being a better return for creditors or shareholders, is in line with the aims of rescue provisions in other jurisdictions and is characteristic of a corporate rescue procedure. The secondary objective imposes a less onerous duty on the directors,[127] affected persons[128] or business rescue practitioner than the primary object of saving the company as a going concern.[129]

According to Loubser[130] the definition is slightly misleading as it refers to the rehabilitation of a company that is financially distressed, but being financially distressed is not the only (or always a) requirement for the commencement of business rescue proceedings but only one such requirement. In case of commencement by order of court, the requirement of financial distress can be substituted by two other possibilities that may not necessarily be an indication of financial distress, being that the

124 Kunst *et al Meskin Insolvency Law and its operation in Winding Up* (loose-leaf 2016 update 18.3.2 (hereafter referred to as Meskin).
125 *Ibid*.
126 *Ibid*.
127 In case of commencement of business rescue by a board resolution.
128 In case of commencement of business rescue by an order of court.
129 See Cassim *et al Contemporary Company Law* (2012) 864 (hereafter referred to as Cassim).
130 Loubser 44.

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 that it is otherwise just and equitable to do so for financial reasons.

Although the term "business rescue" is used to describe this relatively new process, the terms "corporate rescue", "restructuring" and "reorganisation" are all terms that are used to describe essentially the same thing.[131] 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 continue as a successful business on a solvent basis and the secondary objective is that the business rescue yields a better return for its creditors or shareholders. According to Davis *et al*[132] the term "business rescue" is strictly speaking a corporate rescue procedure in that its primary aim is not just to rescue a company's business or potentially successful parts of the business, but the procedure aims to rescue the whole company or corporate entity, which could be more difficult. In this respect, according to Davis *et al*,[133] the new procedure is similar to judicial management as the definition does not even mention the rescue of the business or part of it as one of the aims of the procedure.

It is submitted that the second objective can be used to facilitate the rescue of the business or part thereof, as selling a company's business will most probably result in a better return for creditors than liquidation. In terms of the second objective, the business of the company may be sold as a going concern, which could mean that employees' jobs can be saved, or its assets may be sold, resulting in a better return for creditors in cases where the company cannot be saved. In the circumstances where all the assets are sold, neither the company nor the business of the company is saved.

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131 Davis *et al* 235. See also Cassim 861; Henochsberg 447; Meskin 18.1 and 18.4; Levenstein *An appraisal of the new South African business rescue procedure* (LLD thesis 2015 UP) 14, 126 and 269 (hereafter referred to as Levenstein) and Loubser 1.

132 Davis *et al* 237 and Loubser 45.

133 *Ibid.*

The second objective was debated in a number of cases.[134] While these cases are discussed later in chapter four, it should be mentioned that the Supreme Court of Appeal[135] dealt with the uncertainty regarding this requirement, and more specifically whether fulfilling the second objective would constitute a successful rescue as envisaged by the Act. The court agreed with previous decisions by our lower courts which regarded the accomplishment of the second objective as a successful rescue, while referring to Australia's acknowledgement and use of a similar alternative objective in their voluntary administration procedure.

There has been criticism against the inclusion of business rescue proceedings in the 2008 Companies Act rather than in the planned consolidated Insolvency Act, the argument being that business rescue is an insolvency procedure because it is triggered by the insolvency or imminent insolvency of the company. However, Loubser[136] submits that the legislation should strive for the exact opposite and business rescue should not be associated with insolvency law as the stigma of bankruptcy has been identified as one of the reasons why company boards have been unwilling to apply for judicial management. According to Meskin,[137] not including business rescue in a unified insolvency statute has a number of disadvantages, one of the most important being that it can only apply to companies and close corporations and to no other forms of business enterprises such as partnerships, business trusts and sole proprietorships. Loubser[138] submits that it is unfortunate that the Department of Trade and Industry linked business rescue proceedings with insolvency by requiring that the company must be on the verge of insolvency to enter business rescue proceedings, and by making principles of insolvency law, such as the order of preference of creditors, applicable to rescue proceedings. Business rescue should be regarded as an independent corporate procedure to assist companies in financial diffi-

134 *Nedbank Limited v Bestvest 153 (Pty) Ltd; Essa v Bestvest 153 (Pty) Ltd* 2012 5 SA 497 (WCC); *AG Petzetakis Internatonal Holdings Limited v Petzetakis Africa (Pty) Ltd* 2012 5 SA 515 (GSJ); *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* 2013 4 SA 539 (SCA); *Koen v Wedgewood Village Golf and Country Estate (Pty) Ltd* 2012 2 SA 378 (WCC); *Prospec Investment (Pty) Ltd v Pacific Coast Investment 97 Ltd* 2013 1 SA 542 (FB); *Southern Palace supra* note 94.

135 *Oakdene supra* note 134.

136 Loubser 49.

137 Meskin 18.1.

138 Loubser 50.

culties, preferably before actual or commercial insolvency has set in, to survive these crises and not as merely another route to inevitable liquidation.[139]

The business rescue process is intended to provide a reasonable balance between the interests of the debtor company, which is given the opportunity to prepare a rescue plan with some protection from action by creditors, and the creditors themselves who have a right to vote on the plan.[140] The general interpretation section[141] of the 2008 Companies Act states that the Act must be interpreted and applied in a manner which gives effect to its purposes. Some of these purposes which, in my opinion, are relevant to business rescue include promoting the South African economy by encouraging entrepreneurship and enterprise efficiency,[142] creating flexibility and simplicity in the formation and maintenance of companies,[143] encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation,[144] promoting innovation and investment in the South African markets,[145] reaffirming the concept of the company as a means of achieving economic and social benefits[146] and providing for the efficient rescue and recovery of financially distressed companies in a manner that balances the rights and interests of all relevant stakeholders.[147] The business rescue provisions therefore must be addressed in the context of these purposes, especially in view of the purpose set out in section 7(k) of the Act.

Directors need to give notice of a company's financial distress even if they do not commence business rescue proceedings, which is in line with section 7(b)(iii) as it encourages transparency. By means of enhanced business rescue procedures, distressed companies have the opportunity of maintaining their status as going concerns. This will ultimately boost businesses in South Africa, improving investments and trade through the consistency and reliability of the companies, in accordance

139 *Ibid*.
140 Rushworth "A critical analysis of the business rescue regime in the Companies Act 71 of 2008" 2010 *Acta Juridica* 275.
141 Section 5(1).
142 Section 7(b)(i).
143 Section 7(b)(ii).
144 Section 7(b)(iii).
145 Section 7(c).
146 Section 7(d).
147 Section 7(k).

with section 7(c), that is in harmony with international standards and which will simultaneously ensure that jobs are kept and economic and social benefits for all are maintained by the community as seen in section 7(d).[148]

A balance in accordance with section 7(k) is accomplished and/or encouraged by various provisions in Chapter 6 of the Act. The business rescue proceedings are concerned not only with repaying creditors, but also with protecting all affected parties by appointing a business rescue practitioner to ensure that the various interests at stake are equitably balanced within the constraints of the legislation.[149] Although the Act makes it fairly easy to commence business rescue proceedings,[150] there is positive measures in the Act to combat abuse of process in that the time constraints from the initiation of business rescue are fairly onerous, which may only be extended either by obtaining consent from affected parties or through application to court. The Act provides for a more efficient rescue of financially distressed companies, which protects the rights of stakeholders by giving them a permanent role in the rescue process.[151] The intervention of the courts when businesses unjustifiably use business rescue proceedings to the detriment of creditors will provide creditors with confidence in knowing that their interests are safeguarded against reckless business management.[152] It is debatable whether the costly and time-consuming remedy of obtaining an order of court will prove to be a very effective weapon against abuse, but making it too easy to reverse a board's decision will undoubtedly undermine the success of the business rescue proceedings.[153]

The Act encourages good creditors' and employees' participation by affording them with the right to be notified,[154] to participate,[155] to form a creditors committee[156] and

148 Loubser "Judicial management as a business rescue procedure in South African corporate law" 2004 *SA Merc LJ* 137 162.

149 Bradstreet "The new business rescue: Will creditors sink or swim?" 2011 *SALJ* 355.

150 This will become clear later in this chapter.

151 Salant "Business rescue operations and the new Companies Act" 2009 *De Rebus* 7.

152 *Ibid*.

153 Loubser "The business rescue proceedings in the Companies Act of 2008: Concerns and questions (part 1) 2010 *TSAR* 505.

154 In terms of section 145(1)(a) creditors are entitled to be notified of all court proceedings, decisions, meetings or events concerning the business rescue proceedings. Section 144(3)(a) affords employees with the same rights.

155 In terms of subsections 145(1)(b), (c) and (d) creditors are entitled to participate in any court proceedings or business rescue proceedings and they are allowed to make proposals for a business

*continued on next page*

the right to vote on the business rescue plan.[157] At a time when providing and maintaining jobs is vital, the business rescue provisions contained in the Act go a long way in affording employees and other affected persons the right to express their views on the rescue plan and provide a practical mechanism which has a more than even chance of succeeding and avoiding a liquidation.[158] The business rescue practitioner is expected to express an opinion at various stages of the business rescue procedure as to whether there still is a reasonable prospect of rescuing the company. Only if there is a reasonable prospect of rescuing the company will the business rescue practitioner, in consultation with all the stakeholders, attempt to develop a business rescue plan.

According to Meskin[159] the business rescue provisions contain the essential characteristics of a modern and effective rescue mechanism in that they make provision for the following:

"i. both a voluntary and compulsory initiation of the procedure providing an inexpensive alternative that is relatively simple and not too onerous;
ii. general moratorium which is a crucial element giving the company sufficient breathing space to be able to find a solution to its financial problems;
iii. post commencement finance which provides for the repayment of post business rescue commencement loans before the pre business rescue creditors are paid and they can obtain security over the unsecured assets of the company;
iv. development and implementation of a business rescue plan in consultation with all the relevant stakeholders of the company;
v. all stakeholders are bound by the terms of the business rescue plan once the plan has been accepted;

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rescue plan to the practitioner. Section 144(3)(b) and (d) affords employees with the same rights.

156 The creditors of a company are entitled to form a creditors' committee and through that committee are entitled to be consulted by the practitioner during the development of the business rescue plan in terms of section 145(3). Section 144(3)(f) provides for the forming of an employees' committee.

157 In terms of section 145(2) each creditor has the right to vote to amend, approve or reject a proposed business rescue plan, in the manner contemplated in section 152 and, if the proposed business rescue plan is rejected, a further right to propose the development of an alternative plan, in the manner contemplated in section 153 or present an offer to acquire the interests of any or all of the other creditors in the manner contemplated in section 153.

158 Salant 2009 *De Rebus* 7.

159 Meskin 18.2.

vi. very short timeframes within which the business rescue procedure is to be completed. It is in the interests of the company and the relevant stakeholders that the process be completed as quickly as possible."

### 3 3 Initiation of business rescue proceedings

There are two ways of commencing business rescue proceedings. The process begins either by means of a resolution of the board of directors of the company,[160] or through successful application to the High Court by an affected person.[161] According to Levenstein[162] the gateway into a restructuring/rescuing regime is of fundamental importance. It must be easy for a financially distressed company to enter into a "protective regime" where it will have the opportunity to be rescued.[163] While different parties may commence the proceedings, the main requirements are essentially the same in that the company must be financially distressed and there must be a reasonable prospect of rescuing the company. As is discussed later in this chapter, the requirement of "financially distressed" may be substituted with two alternative grounds in the case of commencement through application to court.

#### 3 3 1 Commencement by board resolution

The procedure to commence business rescue proceedings by resolution of the board of directors involves passing a resolution by the board,[164] filing the resolution with the CIPC,[165] notifying all affected parties within five business days of filing the resolution with the CIPC[166] and appointing a business rescue practitioner within five business days of filing the resolution.[167] Business rescue commences as soon as the resolution is filed with the CIPC and not when the resolution is adopted.[168]

Section 129 provides that the board of a company may pass a resolution by majority vote[169] (or by the majority of the board giving written consent) that the company vol-

160 Section 129.
161 Section 131.
162 Levenstein 563.
163 *Ibid*.
164 Section 129(1).
165 Section 129(2)(b).
166 Section 129(3)(a).
167 Section 129(3)(b).
168 Section 129(2)(b) and 132(1)(a)(i).
169 In *DH Brothers Industries* (*Pty*) *Ltd v Gribnitz* 2014 1 SA 103 (KZP) the court held that a resolu-

*continued on next page*

untarily begin business rescue proceedings and place the company under supervision, if the board has reasonable grounds to believe that the company is financially distressed and there appears to be a reasonable prospect of rescuing the company.[170] One might say that an additional requirement is that business rescue proceedings may be initiated only if no liquidation proceedings[171] have been initiated by or against the company.[172]

Although the term "may resolve" indicates a choice on the part of the board to adopt a business rescue resolution, it must be borne in mind that should the board opt not to adopt such a resolution in circumstances where the company is clearly financially distressed, there are consequences which may result in the company being placed under compulsory business rescue.[173] Once the board has reasonable grounds to believe that the company is financially distressed, it must either pass a business rescue resolution or deliver a written notice to each affected person explaining on which of the two possible grounds the company is believed to be financially distressed and why they have decided not to adopt a business rescue resolution.[174] Some of the reasons a board could put forward for not adopting a business rescue resolution is that there is an application pending for the liquidation of the company[175] or there is no reasonable prospect of rescuing the company[176] which might lead to creditors instituting liquidation proceedings against the company.[177]

Only the board of a company may take a resolution to begin business rescue proceedings voluntarily and the members therefore are excluded from adopting such a

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tion that had only been adopted by one of the two directors of the company amounted to a failure to satisfy the procedural requirements of section 129 and as a result fell to be set aside.

170 Section 129(1)(a) and (b).

171 The Supreme Court of Appeal in *Richter v ABSA Bank Limited* [2015] JOL 33329 (SCA) par 16 has clarified the meaning of the phrase "liquidation proceedings" used in section 131(6) and (7) of the Act. In terms of this judgment, a proper interpretation of "liquidation proceedings" in relation to section 131(6) means proceedings that occur after a winding-up order to liquidate the assets and account to creditors, up to deregistration of a company.

172 Section 129(2)(a); Davis *et al* 247.

173 Meskin 18.4.1.1.

174 Section 129(7).

175 Section 129(2)(a).

176 Section 129(1)(b).

177 See Loubser 31 and Meskin 18.4.1.6 for a more detailed discussion of the required notice to affected persons and the possible reasons for sending out such a notice instead of commencing business rescue proceedings.

resolution at a general meeting.[178] Loubser[179] is of the opinion that it is unnecessary to grant this power to members as the directors would be the first to know about impending financial problems, and calling a meeting of members would furthermore take time and publicise the company's financial situation before the company is protected by a moratorium. This procedure is an improvement on judicial management as it is not necessary to go through court, rendering this procedure faster, easier and less expensive. The fact that the voluntary entry into business rescue occurs by the mere passing of a board resolution reflects the legislature's intention to make rescue and restructuring an easier mechanism to secure a "fresh start", and to support a shift to a more debtor-friendly approach even though our insolvency law system is largely creditor-friendly.[180]

Because the initiation of voluntary business rescue proceedings has been made easy and inexpensive it is open to potential abuse and the legislature has sought to protect affected persons by making provision for them to approach the court in appropriate circumstances.[181] Consequently, an affected person may apply to court for an order setting aside the business rescue resolution adopted by the board,[182] setting aside the appointment of the business rescue practitioner[183] or requiring the appointed business rescue practitioner to provide security.[184]

Until a business rescue plan is adopted in terms of section 152 any affected person may apply to court to set aside the resolution on any of the following grounds:

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178 In the unreported case of *De Bruyn v Conradie* 18679/2011 4455/14 2014 (WCC) the court held that a provision in a shareholders agreement providing that the permission of all shareholders must be obtained before commencing business rescue proceedings precludes the directors from taking a decision on their own to commence business rescue. The court found that the shareholders agreement merely ads another "layer" of decision making and is therefore not in conflict with section 129 of the Act and in line with section 15(2)(a)(iii) thereof, which provides that the Memorandum of Incorporation may include such a provision. This, according to Meskin *et al Henochsberg on the Companies Act 71 of 2008* (2011+) 457 (hereafter referred to as Henochsberg), is incorrect as section 15(2)(a)(iii) provides for a Memorandum of Incorporation to include such a provision and not a shareholders agreement. Henochsberg further submits that such a provision in a shareholders agreement could be a breach of the director's duties in terms of section 76 and could also be a breach of the duty to exercise an independent discretion.

179 Loubser 50.

180 Levenstein 635; Cassim 866.

181 Section 130.

182 Section 130(1)(*a*).

183 Section 130(1)(*b*).

184 Section 130(1)(*c*).

(i) there is no reasonable basis to believe that the company is financially distressed;[185]

(ii) there is no reasonable prospect that the company will be rescued;[186] or

(iii) the company has failed to comply with the procedures set out in section 129.[187]

Although such an application may cause creditors to incur a lot of costs, provision is made for the directors of a company to be held liable for such costs in cases of abuse of the proceedings.[188] It is unclear whether the use of the present tense in phrasing the first two grounds for setting aside the resolution is merely an example of bad drafting or was intended to mean that the court may consider the situation of the company at the time of the application rather than at the time that the resolution was adopted.[189]

In *DH Brothers*[190] it was held that the requirements of section 130(1)(a)(i) and (ii) must be as at the time of considering the application to set aside the business rescue proceedings, rather than at the time when the resolution was adopted, while the requirements of section 130(1)(a)(iii) relate to actions to be taken after the date of the resolution. It is submitted in Henochsberg[191] that the view taken in *DH Brothers*[192] is incorrect in respect of the first two subsections, as the application is for setting aside the resolution because, when it was taken, those requirements have not been complied with, and this view would lead to an untenable position as uncertainty would prevail until the adoption of a business rescue plan. The preferable interpretation according to Henochsberg[193] therefore would be that the first two requirements should be tested as at the date on which the resolution was adopted and, when the application is brought because of a later positive change in the position of the company, which excludes the circumstances as in the first two subsections, it would mean that business rescue cannot be effected.

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185 Section 130(1)(*a*)(i).
186 Section 130(1)(*a*)(ii).
187 Section 130(1)(*a*)(iii).
188 Section 130(5)(c)(ii).
189 Loubser 2010 *TSAR* 505.
190 *Supra* note 169 par 12.
191 Henochsberg 464(5).
192 *Supra* note 169.
193 Henochsberg 464(5).

Section 129 seems to indicate that the directors must first really believe that the company is financially distressed and there is a reasonable prospect of rescuing the company and secondly they must have good reasons for this belief.[194] There are a number of tests for reasonableness that have to be satisfied before the directors may commence with the proceedings. Appropriate levels of comfort to meet these tests will have to be obtained by the directors and a record of how they are satisfied noted appropriately in case there is a subsequent challenge.[195] The various requirements for placing a company under business rescue voluntarily by resolution indicate that such a resolution must be taken in good faith.[196]

According to Loubser,[197] the requirement that the board must have reasonable grounds for believing, and not merely that reasonable grounds must exist, implies that the test is both objective and subjective: whether a reasonable person, with the knowledge, experience and insight of the directors, would believe that these circumstances exist. Loubser[198] states, however, that the grounds for applying to court to have a resolution set aside when "there is no reasonable basis" for the belief that the company is financially distressed, and "there is no reasonable prospect of rescuing the company" seem to require a purely objective test.

The court may set aside the business rescue resolution on any of the stipulated grounds on which such an application may be based, or simply because the court regards it as just an equitable to do so.[199] It is uncertain whether the discretion given to the court in section 130(5)(a)(ii) is also a ground for an application to set aside the resolution as provided for in section 130(1).[200] The Act does not indicate what would

194 Loubser 55.
195 Rushworth 2010 *Acta Juridica* 378.
196 *Griessel v Lizemore* 2015 4 SA 433 (GJ).
197 Loubser 56.
198 *Ibid*.
199 Section 130(5)(a). See Davis *et al* 242.
200 In *DH Brothers supra* note 169 par 12 it was stated *obiter* that an application cannot be based on the grounds that it would be just and equitable in terms of section 130(5) because the application would then not qualify as one brought in terms of section 130(1)(a). The court further stated that this gives rise to an anomaly as relief can be granted by the court on a cause of action which cannot be relied on by an applicant and therefore held that it was clearly a drafting error and that the only sensible meaning is to construe the just and equitable basis as an additional ground. It was held that this ground could be relied on as a cause of action for relief in an application brought to set aside business rescue proceedings. This view was accepted in *Absa Bank Limited v Caine* (3813/2013, 3915/2013) 2014 ZAFSHC 46 where the court held that an applicant can re-

*continued on next page*

constitute just and equitable grounds for setting aside a board resolution which is very regrettable considering the history of this requirement in respect of judicial management.[201] A crucial question is whether our courts will interpret this phrase in the same way as in cases decided on the just and equitable requirement for judicial management.[202] According to Loubser[203] this would prove disastrous since any application by a creditor who insists on immediate winding-up of the company would then almost always be regarded as a just and equitable reason to set aside the resolution unless very special and extra-ordinary circumstances exist.[204] Before a court decides whether or not to set aside the resolution, it may ask the business rescue practitioner to report to the court whether, in his or her opinion, the company appears to be financially distressed or whether there is a reasonable prospect of rescuing the company.[205]

### 3 3 2 Commencement by order of court

An affected person may apply to a court[206] at any time for an order placing the company under supervision and commencing business rescue proceedings, unless a company has adopted a resolution contemplated in section 129.[207] According to Loubser,[208] the exclusion of both the board and the individual directors from the list of applicants or affected persons is regrettable since no board resolution to commence rescue proceedings may be taken after liquidation proceedings have been

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ly on the just and equitable ground as an additional ground. However, the Supreme Court of Appeal in *Panamo Properties (Pty) Ltd v Nel* 2015 5 SA 63 (SCA) stated that "the legislation uses the disjunctive word 'or', where the provisions are to be read conjunctively and the word 'and' would have been more appropriate. Where to give the word 'or' a disjunctive meaning would lead to inconsistency between the two subsections it is appropriate to read it conjunctively as if it were 'and'. This has the effect of reconciling s 130(1)(a) and s 130(5)(a) and limiting the grounds upon which an application to set aside a resolution can be brought, whilst conferring on the court in all instances a discretion, to be exercised on the grounds of justice and equity in the light of all the evidence, as to whether the resolution should be set aside… In my view the word is used in this context to convey that, over and above establishing one or more of the grounds set out in s 130(1)(a), the court needs to be satisfied that in the light of all the facts it is just and equitable to set the resolution aside and terminate the business rescue".

201 See chapter 2 par 2 3 5 for a discussion on the history of this requirement.

202 Loubser 2010 *TSAR* 506.

203 *Ibid*.

204 See *Silverman supra* note 1 352.

205 Section 130(5)(b).

206 Section 128(3) provides that the Judge President of the High Court may designate a judge of the court as a specialist to determine issues relating to commercial matters, commercial insolvencies and business rescue.

207 Section 131(1).

208 Loubser 44.

initiated, even if the board is convinced that the company can be rescued. This is unfortunate as a director who believes that a company is financially distressed and wants to place the company in business rescue who is outvoted by other directors will not be able to apply to court in his capacity as director, in spite of being subject to the risk of personal and criminal liability for trading under insolvent circumstances.[209]

When considering a business rescue application, a court may make an order placing a company under supervision and commencing business rescue proceedings if it is satisfied that the company is financially distressed,[210] or 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,[211] or it is otherwise just and equitable to do so for financial reasons[212] and there is a reasonable prospect for rescuing the company.[213] It should be noted that the second threshold above does not require a series of failures to pay – just one failure to pay suffices, which according to Cassim[214] is "unduly harsh, with an element of overkill" as a technical default may often be re-negotiated or remedied without the need for the business rescue procedure.

It should be noted that these grounds are more extensive than those in respect of which the directors may pass a resolution commencing business rescue proceedings, in that they are not limited to cash-flow and balance-sheet insolvency as there are two alternative grounds on which the court may order the commencement of business rescue proceedings. The business rescue proceedings therefore will not necessarily commence only if the company is in financial difficulty.

While the first requirement under section 131(4), that the company must be financially distressed, turns on a question of fact, the second requirement as to whether there

209 See section 22(1)(b), 77(3)(b) and 214(1)(c) respectively. Loubser 51.
210 Section 131(4)(a)(i).
211 Section 131(4)(a)(ii).
212 Section 131(4)(a)(iii).
213 Section 131 (4)(a).
214 Cassim 874.

is a reasonable prospect for rescuing the company lies in the discretion of the court.[215]

The test is stricter in an application to court compared to a board resolution as the court must not merely be satisfied that there are reasonable grounds to believe that the company is financially distressed and that there appears to be a reasonable prospect of rescuing the company, but must be satisfied that the company is financially distressed and that there is a reasonable prospect of rescuing the company.[216] Even though the test is stricter than in the case of a resolution, the applicant still bears a lighter burden of proof than in the case of judicial management.[217]

In order to bring an application to court, the applicant must serve a copy of the application on the company and the CIPC and notify each affected person of the application in the prescribed manner.[218] Each affected person has a right to take part in the hearing of such an application.[219] Liquidation proceedings[220] are suspended when an application for business rescue is brought and remain suspended until the court refuses the application for business rescue or until the business rescue application is granted. In terms of section 132(1)(b) the business rescue proceedings begin when an affected person applies to court for an order placing the company in business rescue. The Act does not explain at what moment this will be but it probably also refers to the time of filing the application.[221]

If the court makes an order commencing the proceedings, it may appoint an interim business rescue practitioner nominated by the affected persons who commenced the

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215 Meskin 18.4.3.
216 Loubser 60.
217 *Ibid*.
218 Section 131(2). Rogers AJ remarked in *Cape Point Wineyards (Pty) Ltd v Pinacale Point Group Ltd* 2011 5 SA 600 (WCC) that the requirement in regulation 124 under the 2008 Companies Act, that a copy of the whole application and not just a notification of the application must be delivered to affected persons, was problematic since a company could have thousands of shareholders and neither physical delivery nor sending such a data-heavy file by email may be feasible. In *Kalahari Resources (Pty) Ltd v Arcelor Mittal SA* 2012 3 SA 555 (GSJ) it was held that regulation 124 could not just be ignored and until declared invalid, its requirements had to be complied with.
219 Section 131(3).
220 In *Van Staden v Angel Ozone Products CC* 2013 4 SA 630 (GNP) it was held that "proceeding" referred to the whole winding up process until it ends with the approval of a final liquidation and distribution account.
221 Davis *et al* 245.

proceedings.[222] This appointment is subject to the ratification by the holders of a majority of the voting interest of independent creditors at the first meeting of creditors.[223] The court may, after considering an application, dismiss it and, in doing so, may make other orders, for instance placing the company under liquidation.[224]

### 3 4 Initiating requirements for business rescue

#### 3 4 1 Financially distressed

Section 129(1) provides that the board may resolve to voluntarily commence business rescue proceedings and place a company under supervision if it has reasonable grounds to believe that the company is financially distressed. This is not the only requirement to commence business rescue as will become clear from the discussion below. “Financial distress” is the trigger to the business rescue process and gives rise to the basic and initial question of how to assess whether a company is financially distressed.[225]

Unfortunately the provisions of Chapter 6 of the Act do not explain the meaning of the term “reasonable grounds to believe” as used in the context of section 129(1). Henochsberg[226] submits that “reasonable grounds to believe” refers to the company’s specific circumstances at the time, which will be known to the board, which is a subjective test, but that “reasonable prospect” is an objective test.[227]

In terms of section 128(1)(f) a company is “financially distressed” if 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 it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months. According to Cassim[228] the word “appears” in this section probably imposes a lower standard of proof in respect of the matters of which the court must be satisfied.

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222 Section 131(5).
223 Section 131(5).
224 Section 131(4)(b).
225 Cassim 864.
226 Henochsberg 451.
227 See also Meskin 18.4.1.1 in this regard.
228 Cassim 864.

The words “unlikely that the company will be able to pay” implies that it is a situation that may occur in the future.[229] The company is not at this stage insolvent, either in the balance-sheet insolvency sense or in the cash-flow or liquidity sense.[230] Companies do not have to be in an extreme dire position, as is the case of judicial management, to commence business rescue proceedings.[231] For “distressed” we may read “ailing”, according to *Welman v Marcelle Props 193 CC*,[232] as business rescue is meant for neither the “terminally” nor the “chronically” ill. This enhances the chances of survival of companies as they will ultimately be in a better financial position than those under judicial management that were completely unable to pay their debts.

Traverso J[233] held that the definition of “will become insolvent” refers to future factual insolvency and where the company is already factually insolvent the business cannot be placed in business recue. Van der Byl AJ[234] stated *obiter* that the term “financially distressed” as defined in the 2008 Companies Act does not refer to current insolvency but future insolvency and where a company is presently insolvent the court would most probably issue a liquidation order. In *Newcity Group (Pty) Limited v Pellow*[235] the company was both factually and commercially insolvent. However, the court held that the issue on appeal was whether placing the company in business rescue could show a reasonable prospect of rescuing the company, besides being actually insolvent. Various courts have shown that the fact that a company is already insolvent and unable to pay its debts will not necessarily lead to the dismissal of the application for commencement of business rescue; however it will be a factor to be considered when assessing the reasonable prospect of rescuing the company.[236]

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229 *Ibid*.
230 *Ibid*.
231 Loubser 54.
232 [2013] JOL 30620 (GSJ) 12 par 28.
233 *Gormley v West City Precinct Properties (Pty) Ltd, Anglo Irish Bank Corporation Ltd v West City Precinct Properties (Pty) Ltd* 2013 JDR 1895 (WCC).
234 *Firstrand Bank Ltd v Lodhi 5 Properties Investment CC* 2013 3 SA 212 (GNP).
235 [2015] JOL 33538 (SCA) 162.
236 *Southern Palace supra* note 94; *Swart v Beagles Run Investments 25 (Pty) Ltd* 2011 5 SA 422 (GNP). For a more detailed discussion, see Davis *et al* 246.

The first of the tests to prove financial distress concerns commercial or cash-flow insolvency on the basis that the company is unable to pay its debts as they fall due.[237] The second is presumably factual insolvency, a balance-sheet test, on the basis that the company's liabilities exceed its assets at any particular time.[238] According to Levenstein[239] these tests are in line with international tests/eligibility for entry into the rescue process. The cash-flow test can be more critical, as it is generally fairly clear when a company simply cannot meet its liabilities from its cash flow.[240] However, according to Rushworth,[241] establishing values for a balance-sheet test at any particular time can be subject to many variables and uncertainties, for instance the basis of valuation and whether a guarantee of another company debt is treated as a liability.

A court may order any director who voted in favour of the business rescue resolution to pay the costs of the application if it sets aside the resolution because there were no reasonable grounds for believing that it was unlikely that the company would be able to pay all of its debts as they become due and payable.[242] Loubser[243] submits that it is unfortunate that the section does not use the term "financially distressed" to describe the circumstances under which a director may be held liable as this is how the pre-condition for taking the resolution is stipulated. A resolution based on the fact that a company is reasonably likely to become insolvent in the next six months does not carry the same risk of personal liability. Loubser[244] rightly states that directors will hesitate to take this route if there is a real danger of personal liability for costs if they eventually appear to have been overcautious when viewed with the advantage of hindsight by the court. She is of the opinion that it may also encourage directors to choose liquidation over business rescue proceedings since there is no risk of personal liability for a winding-up application made in good faith. On the other hand, this will prevent directors from abusing the process as they might be held personally liable.

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237 Rushworth 2010 *Acta Juridica* 376; see also Levenstein 564 in this regard.
238 Rushworth 2010 *Acta Juridica* 377.
239 Levenstein 564.
240 *Idem* 275.
241 *Ibid*.
242 Section 130(5)(c)(ii). The court will not make an order for costs against the director who can satisfy the court that he or she acted in good faith and on the basis of information that he or she was entitled to rely on in terms of section 76(4) and (5).
243 Loubser 2010 *TSAR* 506.
244 *Ibid*.

In order for an affected person to apply to court to place a company under business rescue, the affected person must prove to court that the company is financially distressed. This might not be easy to prove, as affected persons are either employees, creditors, or trade unions, all of whom seldom have access to company records, especially financial documents. This has been made easier in the case of trade unions by section 31(3) which gives any trade union the right to demand access to company financial statements[245] through the commission and subject to such conditions as the commission may determine, for the purpose of initiating business rescue proceedings.[246]

Kollapen J[247] stated that "[the court] must have regard to what information the affected party who brings the application is able to present given its own position *vis à vis* the company". In *Newcity Group*[248] the court stated that "one can envisage that in some instances the modicum of evidence required will be less than in others, such as where the application is brought by someone without in depth knowledge of the affairs of the company".

It is unfortunate that there is no provision for a deemed inability of the company to pay its debts based on external evidence and similar to the provisions for the winding-up of a company as it will be very difficult, if not impossible, for an outsider to prove that a company is financially distressed.[249] Loubser[250] is of the opinion that the definition of "financially distressed" should be broadened to include circumstances in which a company will be deemed to be financially distressed. According to her the deeming provisions should include failure by the company to pay over any amount in respect of employment-related obligations for at least two consecutive months, fail-

245 In terms of the definition in section 1, these would include annual and provisional annual financial statements, interim preliminary reports, group and consolidated financial statements, and any financial information contained in a prospectus, circular or provisional announcement of results. Loubser submits on page 54 that it is unclear why the company should be required to make these documents available since it would have been published, unless the intention behind this subsection is to give trade unions access to confidential and unpublished financial information of the company.

246 See Loubser 54.

247 *Employees of Solar Spectrum Trading (Pty) Ltd v Afgri Operations Ltd; In re Afgri Operations Ltd v Solar Spectrum Trading (Pty) Ltd* unreported case 6418/11, 18624/11, 66226/11 (GNP) par 17.

248 *Supra* note 235 par 14.

249 Loubser 60.

250 Loubser 2010 *TSAR* 511.

ure to pay a creditor within three weeks of receiving a demand for a stipulated minimum amount or a *nulla bona* return by the sheriff after a creditor has obtained a judgment against the company. As will become clear from the discussion below, in the case of commencement by order of court, the requirement of financial distress can be substituted by two other possibilities that may not necessarily be an indication of financial distress.

The use of the word "insolvent" as opposed to the exact definition of factual insolvency is unfortunate as "insolvency" can mean both actual and commercial insolvency.[251] Without well-defined guidelines, there is a risk that many tactics may be employed by the management of companies relative to the differences between solvency and pending insolvency, especially considering the consequences which might follow as a result of failure by them to pass a resolution placing the company under supervision where the company is clearly in financial distress.[252]

In their submissions on the Companies Bill to the Portfolio Committee on Trade and Industry, KPMG auditors suggested that the period of six months stipulated in the test for financial distress should be increased to twelve months.[253] Loubser[254] agrees with this, submitting that financial planning of a company usually stretches over the next financial year, being twelve months, and that a period of six months is too short as it may deprive a company of the opportunity to take the necessary steps to protect itself in good time from a financial risk or impending crisis that is foreseeable more than six months prior to its occurrence, such as a claim for damages. This is, however, an improvement on the requirement for judicial management which required proof that the company was already unable to pay its debts.[255]

There are two alternative grounds for a court order to commence business rescue, which can substitute the requirement of financial distress. These grounds, being that 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

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251 Henochsberg 452.
252 *Ibid* and Meskin 18.3.5.
253 KPMG *Comments on the Companies Bill, 2008* (2008) 13.
254 Loubser 58.
255 Section 427(1)(a) of the 1973 Companies Act.

or it is otherwise just and equitable to do so for financial reasons, are discussed in more detail under paragraphs 3 4 4 and 3 4 5 below.

### 3 4 2 Reasonable prospect of rescue

In order for a company to voluntarily commence business rescue proceedings the board needs reasonable grounds to believe that there appears to be a reasonable prospect of rescuing the company.[256] It would appear that one need not prove that the rescue will succeed, but merely that reasonable prospects exist. The prospects should thus be objectively assessed and possible and should certainly be demonstrated in any application for business rescue.[257]

The application and meaning of the "reasonable prospect" requirement seem to be more or less the same for both the resolution by the board of the company and an application to court. In *Finance Factors CC v Jayesem* (*Pty*) *Limited*[258] the court found that the determination of whether there is a reasonable prospect of rescuing the company under section 130(1)(*a*)(ii)[259] is the same as under section 131, and that the case law that had already been generated in this regard was of equal application.

Meskin submits[260] that a distinction must be drawn between the position where the board adopts a resolution to place a company under supervision under section 129(1), and that where an affected person brings an application to place the company under supervision under section 131, as in the case of a voluntary business rescue resolution, the board will have full knowledge of the company's financial situation, what it is capable of achieving and what would reasonably be required to rescue the company. This is in contrast to the knowledge of the company's affairs that an affected person may have when an application is brought under section 131(4). According to Joubert,[261] based on the knowledge available to the different applicants,

256 Section 129(1)(b) of the 2008 Companies Act.
257 Wassman "Business rescue – Getting it right" 2014 *De Rebus* 4.
258 [2013] JOL 30701 (KZD) 45.
259 Section 130(1)(a)(ii) allows an affected person to apply to court to set aside a resolution that was taken in terms of section 129 on the ground that there is no reasonable prospect. Reasonable prospect in this regard accordingly refers to the section 129 reasonable prospect requirement.
260 Meskin 18.4.3.
261 Joubert 2013 *THRHR* 555. See also Henochsberg 452, 463 and 464 for a discussion of the dual

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there might be a different interpretation of the reasonable prospect requirement depending on the route taken.

It is unfortunate that, despite the abundance of criticism regarding judicial management and especially the use of the requirement of reasonable probability, the legislature did not provide a definition for "reasonable prospect" and overlooked the need for a clearly formulated burden of proof in the new business rescue regime.[262] Levenstein[263] submits that the clarification of the test for what constitutes a "reasonable prospect", as set out in sections 129(2)(b) and section 131(4), will serve to create a better understanding for assessment of entry levels into the rescue process.

Many writers[264] recommended the use of the phrase "reasonable possibility" as opposed to "reasonable prospect" which is the term used in the 2008 Companies Act. The *Oxford dictionary*[265] defines "reasonable" as "having sound judgement; fair and sensible" and "as much as is appropriate or fair; moderate". The word "prospect" is defined as "the possibility or likelihood of some future event occurring" and the word "possibility" is defined as "a thing that may happen or be the case". In order to place a company under judicial management, a reasonable probability had to be proved. "Probability" is defined as the "extent to which something is probable" and "probable" is defined as "likely to happen or be the case". According to Joubert[266] it is clear, if one considers the definition of "prospect" and "probability", 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".[267] Loubser[268] submits that "reasonable prospect" must be taken to mean a reasonable possibility, but it would have been preferable if the drafters had chosen the word "possibility", as "prospect" could mean either a possibility or a probability.

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gateway.

262 Joubert 2013 *THRHR* 553.

263 Levenstein 601.

264 Loubser 339; Burdette 2004 *SA Merc LJ* 249.

265 Accessed online at https://en.oxforddictionaries.com/definition on 16 June 2016.

266 Joubert 2013 *THRHR* 554.

267 *Ibid.*

268 Loubser 58.

Van Blerk AJ[269] held that the difference between the words "probable" and "possible" was material. He stated that in legal terminology something that is possible is less sure to happen than something that is probable.[270] Eloff AJ[271] referred to the reasonable prospect requirement as the "recovery requirement" which is required as part of the burden of proof for a business rescue order. This requirement, according to *ABSA Bank Limited v Newcity Group (Pty) Limited*,[272] is the threshold consistent with the approach that it is "preferable to rescue a company than to let it drift, or sometimes plummet, into extinction".

The meaning of the words "reasonable prospect" in the context of section 131(4), and what is required to demonstrate this requirement, have been the subject of conflicting decisions. Certain decisions[273] have set a high level of proof for the granting of a compulsory business rescue order while others have taken a more flexible approach.[274] This is illustrated in more detail later in chapter 4 but some of the cases are discussed below.

In *Southern Palace*[275] it was held that a rescue plan had to be provided to the court that addressed the reasons for the company's failure and offered a remedy that had a reasonable chance of being successful. Some concrete and objectively ascertainable details had to be provided, namely:

(i) the likely costs of commencing or resuming the company's business;
(ii) the likely availability and source of capital enabling the company to meet its running expenses;
(iii) the availability of any other necessary resources such as materials and human resources; and
(iv) why the proposed business rescue plan would have a reasonable prospect of rescue.

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269 *Noordkaap Lewende Hawe Ko-op Bpk v Schreuder* 1974 3 SA 102 (A).
270 *Ibid* 110.
271 *Southern Palace supra* note 94.
272 2013 3 SA 146 (GSJ).
273 *Southern Palace supra* note 94*; AG Petzetakis supra* note 134 515*; Koen supra* note 134 380; *Welman supra* note 232.
274 *The Employees of Solar Spectrum supra* note 247; *Nedbank supra* note 134; *Prospec Investment supra* note 134; *Newcity supra* note 235; *Cardinet* (*Pty*) *Ltd v Wedgewood Golf and Country Estate* (*Pty*) *Ltd* unreported case no 19599/2012 (WCC).
275 *Supra* note 94 par 24.

Meskin submits[276] that, while the determination of whether there is a reasonable prospect for rescuing the company cannot be based on mere speculation or conjecture, in the context of Chapter 6 of the 2008 Companies Act there may be many other ways of demonstrating a reasonable prospect of rescuing a company that would fall far short of presenting a full business plan to the court. Meskin[277] provides two such examples, being, firstly, the benefit of a moratorium under section 133 which provides breathing space to the company that may offer sufficient time to allow the company to negotiate a settlement or a repayment plan with its creditors, especially since provision is made for obtaining post commencement finance in terms of section 135. Secondly, in terms of section136 the business rescue practitioner is in a position to suspend temporarily, or perhaps even cancel altogether, the obligations of the company in terms of a burdensome contract that the company is bound to, and which is preventing it from becoming or remaining a successful concern. While the provisions of section 136 may be contentious they are a powerful tool in the hands of the business rescue practitioner and may be crucial in attempting to bring about the rescue of the company.

In *Oakdene*,[278] where the company owned various immovable properties, the following was clearly stated by the Supreme Court of Appeal:

> "'Reasonable prospect' (a term not defined in the Companies Act) does not necessarily mean reasonable possibility; however, it means a prospect based on reasonable grounds and not speculative suggestions or vague averments. An applicant is required to place before the court a factual foundation for the existence of a reasonable prospect that rescue will achieve the primary object or the secondary object of business rescue; whether or not 'reasonable prospect' has been established is a factual inquiry to be made on a case by case basis."

An aspect that has been taken into account by the courts in determining whether or not there is a reasonable prospect of rescuing the company is whether or not the major creditors would support the business rescue plan.[279] In *Nedbank*[280] the court

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276 Meskin 18.4.3.

277 *Ibid.*

278 *Supra* note 134 541.

279 *Gormley supra* note 205 3*; Anglo Irish Bank Corp Ltd v West City Precinct Properties* (*Pty*) *Ltd* unreported case nos 19075/11, 15584/11 (WCC); *The Employees of Solar Spectrum supra* note 247; *Cardinet supra* note 274; *Zoneska Investments* (*Pty*) *Ltd t/a Bonatla Properties* (*Pty*) *Ltd v*

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held, *inter alia*, that it is expected of a responsible creditor to be open to a proposal which could see a company (the debtor) trading under solvent circumstances again or provide a better return for creditors, and may, ultimately, be to the benefit of such creditor. The court further held that an approach by a creditor contrary to what is stated above would not accord with the general purpose of Chapter 6 and that the intended vote against the business rescue plan should not be taken into account when considering an application for business rescue.

In *Employees of Solar Spectrum*[281] the court held that a creditor should vote on a business rescue plan in good faith and should consider the merits and demerits of the plan. The intention of the creditor not to vote for a business rescue plan was not detrimental to the order granted in respect of the application to commence business rescue.

In *Oakdene*[282] the Supreme Court of Appeal held that, in so far as the Western Cape Division in the *Nedbank* case[283] suggested that a creditor's intention to vote against a proposed business rescue plan should be ignored in considering an application in terms of section 131, it could not be correct. The court stated that unless the creditors' attitude can be said to be "unreasonable" or "*mala fide*" it should be taken into account by the court exercising its discretion. It should be kept in mind that there is a possibility in terms of section 153(1) that a court may set aside a vote against a business rescue plan on the basis that it is inappropriate. However, it should also be kept in mind that such a process will take time and attract even further costs.

The court may make an order to commence business rescue proceedings if it is satisfied that the company is financially distressed[284] or that 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[285] or it is otherwise just

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*Midnight Storm Investments 386 Ltd* 2012 4 SA 590 (WCC).

280 *Supra* note 134.

281 *Supra* note 247 359.

282 *Supra* note 134 541.

283 *Supra* note 134.

284 Section 131(4)(*a*)(i).

285 Section 131(4)(*a*)(ii).

and equitable to do so for financial reasons,[286] and there is a reasonable prospect of rescuing the company.[287] The word "and" before the requirement of a "reasonable prospect of rescuing the company" in section 131(4)(*a*) seems to imply that this requirement qualifies each of the grounds preceding it in paragraphs (i), (ii) and (iii) of that subsection, but uncertainty has been expressed by our courts as to whether it is necessary, or even possible, for it to qualify the ground set out in paragraph (ii) of that subsection, being the circumstances where 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.

Van Eeden AJ, in *Newcity Group (Pty) Ltd v Pellow: China Construction Bank Corporation v Chrystal Lagoon Investments 53 (Pty) Ltd*,[288] stated that

> "[o]ne understands the logic of requiring a reasonable prospect for rescuing the company in respect of jurisdictional requirements (i) and (iii), but is (*sic*) seems unnecessary and impossible to require it in respect of (ii) . . . It remains to be seen how the absence of a '*reasonable prospect for rescuing a company*' will derail an application for business rescue based on jurisdictional requirement (ii)".

In *AG Petzetakis*,[289] the court stated that "the requirement for a reasonable prospect of rescuing the Company must be present, irrespective of which of sub-sections (i), (ii) or (iii) is applicable".[290]

### 3 4 3 Rescuing the company

In terms of section 128(1)(h) ''rescuing the company'' means achieving the goals set out in the definition of business rescue. These goals are found in section 128(1)(b)(iii), namely, to maximise the likelihood of the company's continued existence on a solvent basis or, if that is not possible, to result in a better return for creditors or shareholders of the company than would result from the immediate liquidation of the company. The secondary object imposes a less onerous duty on the directors,

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286 Section 131(4)(*a*)(iii).
287 Section 131(4)(*a*).
288 Unreported case 12/45437 and 16566/12 (GSJ) par 18.
289 *Supra* note 134 par 14.
290 This view was supported in *Cardinet supra* note 274 and in *Prospec supra* note 134.

affected persons and business rescue practitioner than the primary object of saving the company as a going concern.[291]

### 3 4 3 1 Company continuing on a solvent basis

The reference to the continued existence of a company in a state of solvency is problematic since it shows some similarity with the requirements for a judicial management order, namely, that of a reasonable probability that the company will be able to pay all its debts if placed under judicial management.[292]

### 3 4 3 2 Better return for creditors or shareholders compared to liquidation

The definition of "business rescue" in section 128 does not state as its only objective the rescue of the company, but also the possibility of devising a plan, if the company cannot be rescued, that results in a better return for creditors or shareholders than the immediate winding-up of the company. Meskin[293] submits that it is unfortunate that neither section 129(1) nor section 131(4) states this alternative objective as a requirement for the commencement of business rescue proceedings, or that Chapter 6 does not define or explain what is meant by the term "reasonable prospect of rescuing the company". The omission of this objective as a requirement has led to some judgments questioning the secondary goal as a legitimate objective of a business rescue application.[294] These judgments are discussed in chapter four.

The business rescue concept recognises that rehabilitation of the company on a solvent basis, pursuant to the proceedings, may not be possible, but that another process, for instance the sale of a business as a going concern, may be more beneficial to creditors or shareholders than immediate liquidation proceedings.[295] Kloppers[296] submits that the survival of the juristic person is not important as a goal in itself, but that it is the survival of the enterprise, and the business carried on by the company, which is the actual goal. Any benefit for shareholders resulting from a successful rescue of a company will be purely incidental as shareholders play almost no role in

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291 Cassim 864.
292 Loubser 45.
293 Meskin 18.4.1.1.
294 See *AG Petzetakis supra* note134 516.
295 Rushworth 2010 *Acta Juridica* 378.
296 Kloppers 1999 *Stell LR* 418.

the proposed business rescue proceedings and it is doubtful whether their interests will be given any serious consideration in a rescue plan.[297]

Loubser[298] is of the opinion that this appendage to the definition of business rescue should simply be removed. She submits that the term "better return", as one of the objects of business rescue, is misleading and not really beneficial as it creates a highly undesirable association with insolvency, and it is difficult to understand how this could be achieved by business rescue proceedings. This objective may result in the commencement of business rescue simply to keep the business running until a purchaser is found, which is unnecessary as a liquidator may also be authorised to continue running a business, if necessary, for the beneficial winding-up thereof. Also, if the company is put through the whole process of business rescue before an unavoidable liquidation, this will result in substantial extra costs that must be paid from the company's already insufficient assets.[299]

In many circumstances, an unsuccessful attempt at business rescue may deplete the financial resources of the struggling company still further, to the detriment of both creditors and shareholders. This objective could, however, be helpful in cases where the company is involved in mining operations where the mining right will automatically come to an end when the company is placed in liquidation or in the case where the company has a lot of government tenders where the liquidation of a company will automatically result in the cancellation of the contract.

In *Southern Palace*[300] it was held that the applicant was expected to provide concrete factual details of the source, nature and extent of resources that were likely to be available, as well as the basis and terms on which they would be available for the court to grant an order for business rescue based on a better return for creditors or shareholders. In *Oakdene*[301] there was no business or employees but merely an immovable property and the court did not grant a business rescue order as there

297 Loubser 46.
298 *Idem* 46 and 47.
299 *Idem* 47.
300 *Supra* note 94 par 25.
301 *Supra* note 68.

was no evidence that a better price would be achieved in business rescue than through a sale in liquidation.

The employees are not mentioned in this objective at all which Loubser[302] finds ironic as they are the only group of people who might be able to benefit from business rescue proceedings preceding liquidation. The employees will benefit from a company's business being sold as a going concern as this would result in them keeping their jobs.

Smits[303] submits that modern corporate rescue and reorganisation seeks to take advantage of the reality that in many cases an enterprise not only has substantial value as a going concern, but its going-concern value exceeds its liquidation value.

### 3 4 4 Non-payment of amounts due in respect of contractual or statutory obligations

When application is made to court, as an alternative to financial distress, an applicant may base the application for business rescue on the non-payment by the company of amounts due in respect of contractual or statutory obligations relating to employment matters.

It is not clear what the justification is for including this as a ground upon which the court may grant an order for the commencement of business rescue proceedings. This provision applies even if only one payment is missed, which could be as a result of an administrative or system failure by the company or its bank, or other reasons which do not relate to financial difficulties.[304] The same ground does not apply under section 129 or 130 and Meskin[305] is of the opinion that it can only have been included in order to assist registered trade unions in bringing applications for compulsory business rescue proceedings in circumstances where they perhaps do not have information as to whether the company is financially distressed.

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302 Loubser 48.
303 Smits 1999 *De Jure* 107.
304 Loubser 2010 *TSAR* 510. See also Cassim 874.
305 Meskin 18.4.3 footnote 21B.

Although companies with cash-flow problems apparently sometimes retain these contributions to alleviate their problems, Loubser[306] believes that non-payment should occur over a stipulated minimum period or frequency before it constitutes a ground for rescue proceedings, and that at least two consecutive payments should be missed in order for an affected person to be able to apply for the commencement of business rescue proceedings.

### 3 4 5 Just and equitable for financial reasons

The second alternative to the company being financially distressed, namely, that the court regards it as otherwise just and equitable for financial reasons,[307] is very vague and it is not at all clear whether these financial reasons must be related to financial difficulties that are not covered by the definition of financial distress.[308] The term "financially distressed" already covers the financial reasons for wanting to place a company under business rescue and it is difficult to think of other circumstances where it would otherwise be just and equitable to place the company under business rescue for financial reasons.[309] According to Loubser[310] "financial reasons" in this case might be circumstances such as a company that may become insolvent or unable to pay its debts over a longer time than stipulated in the definition, or it could possibly also be relied on by shareholders or employees who are of the opinion that as a result of the current mismanagement of the company, it is likely to fail over the longer term.

The court in *Oakdene*[311] stated that the term "otherwise just and equitable to do so for financial reasons" is "extremely vague". This provision will almost certainly lead to interpretational problems based on its vagueness and should preferably be removed. The above difficulties could be solved by broadening the definition of "financially distressed" to include circumstances in which a company will be deemed to be financially distressed.[312] This will also assist applicants who do not have easy access to the financial information required to satisfy the court on this requirement when apply-

306 Loubser 2010 *TSAR* 510.
307 Section 131(4)(a)(iii).
308 Loubser 2010 *TSAR* 511.
309 Meskin 18.4.3 footnote 21C.
310 Loubser 2010 *TSAR* 511.
311 *Supra* note 68 par 17.
312 Loubser 50.

ing for an order to commence the procedure. According to Loubser[313] the deeming provisions should include failure by the company to pay over any amounts in respect of employment-related obligations for at least two consecutive months, failure to pay a creditor within three weeks after receiving a demand for a stipulated minimum amount or a *nulla bona* return from a sheriff after a creditor has obtained a judgment against the company.

Although no guidance is provided as to the meaning of this term, any applicant who brings an application on this ground will simultaneously have to show that there is a reasonable prospect of rescuing the company.

### 3 5 Brief overview of business rescue proceedings after commencement

Since it is not the main theme of this dissertation, a brief overview of business rescue proceedings after commencement will suffice. Once business rescue proceedings commence, either by a resolution or court order, a business rescue practitioner is appointed to take over the management and control of the company in order to attempt to save it. The practitioner must, as soon as practicable after appointment, inform all relevant regulatory authorities having authority in respect of the activities of the company, of the fact that the company has been placed under business rescue proceedings and of his or her appointment.[314] Within ten business days after being appointed, the practitioner must convene and preside over a first meeting of creditors and employees to, amongst other things, inform them of his opinion on whether there is a reasonable prospect of rescuing the company.[315]

The company must publish a business rescue plan within 25 business days after the practitioner was appointment or such longer period as may be allowed by the court or the holders of a majority of creditors' voting interests,[316] after which the practitioner must convene a meeting of the company's creditors and other holders of voting rights to determine the future of the company and consider the business rescue plan

313 Loubser 2010 *TSAR* 511.
314 Section 140(1)(a).
315 Section 147.
316 Section 150(5).

within ten days after the publication of same.[317] The plan will be preliminarily approved if supported by the holders of 75% of the creditors' voting interests that were voted and the votes in support of the plan included at least 50% of the independent creditors' voting interests. If adopted the plan is binding on the company and on all of the creditors and holders of security whether they were present at the meeting or not.

If a business rescue plan is rejected by the creditors, the practitioner may either seek approval from the relevant meeting to prepare a revised plan[318] or inform them that the company will apply to court to have the result of their vote set aside on the grounds that the majority decision was inappropriate.[319] If the practitioner fails to do either of the above, any affected person present at the meeting may ask for approval from the persons who have voting rights that the business rescue practitioner be required to follow one of the above two courses of action.[320] In the alternative, one or more of the affected persons may offer to purchase the voting interests of any of the persons who opposed adoption of the plan.[321]

If a company's business rescue proceedings have not ended within three months of the start of proceedings, the practitioner must prepare a report on the progress of the business rescue proceedings, update it at the end of each subsequent month until the end of those proceedings and deliver the report to each affected person.

In contrast to judicial management, although the practitioner has full management control of the company, he will not replace the existing management. The directors are expected to cooperate with the practitioner and continue to exercise their management functions, subject to the authority of the business rescue practitioner, in accordance with his reasonable instructions or direction.[322] The practitioner will work with the management structures already in place. This factor vastly increases the probability of a successful business rescue as the practitioner will not be expected

317 Section 151(1).
318 Section 153(1)(a)(i).
319 Section 153(1)(a)(ii).
320 Section 153(1)(b)(i).
321 Section 153(1)(b)(ii).
322 Section 142.

single-handedly to turn the company around, but will be able to use the management resources familiar with the operational requirements of the company, saving time for the practitioner to spend on the actual rescue, as opposed to wasting time on becoming acquainted with internal company procedures.[323]

Section 133(1) affords the company an automatic moratorium and provides that no legal proceedings, which include enforcement action against a company, or with regard to property owned by the company or in its lawful possession, may be instituted or proceeded with during business rescue proceedings.[324] In *LA Sport 4x4 Outdoor CC v Broadsword Trading 20 (Pty) Ltd*[325] it was held that "legal proceedings" included termination of a contract. However, this judgment was overturned on appeal in *Murray v Firstrand Bank Limited t/a Wesbank*,[326] where the Supreme Court of Appeal held that cancellation of a contract does not constitute "enforcement action" as envisaged in section 133, and that cancellation of the contract was lawful. The court held that cancellation of a contract is not "the result of the pronouncement by any forum" and was therefore allowed and not subject to the moratorium.

In terms of section 134(1)(c) no one may enforce any right with regard to any property lawfully possessed by the company during business rescue proceedings, whether or not such property is owned by the company, unless the business rescue practitioner consents thereto in writing. The practitioner may not unreasonably withhold consent, taking into consideration the purpose of the chapter, the circumstances of the company and the nature of the property and rights claimed in respect thereof.[327] Such a party could probably apply to court for relief should he feel that the practitioner's conduct is unreasonable.

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323 Salant 2009 *De Rebus* 7.

324 There are, however, a number of exceptions to this rule, namely that the business rescue practitioner may provide written consent to commencement or continuation of the action, the court may provide its consent, if the legal-proceeding is a set-off against a claim made by the company in legal proceedings which commenced before or after business rescue proceedings began, if the proceedings are criminal proceedings against the company, its directors or officers and if the proceedings concern property or rights held by the company as a trustee.

325 Unreported case 25680/2013 GNP.

326 2015 3 SA 438 (SCA) 441.

327 Section 134(2).

During business rescue proceedings, section 136(2)(a) gives the business rescue practitioner the right to suspend, either entirely, partially or conditionally, any obligation which derives from an agreement to which the company was a party prior to the commencement of the proceedings, and which obligation would be owing during the course of the proceedings. Section 136(2)(a) provides that the practitioner may apply urgently to a court to entirely, partially or conditionally cancel, on any terms that are just and reasonable in the circumstances, any obligation of the company contemplated in subsection (2)(a). The period of suspension only continues for the duration of the business rescue proceedings.

Business rescue proceedings are brought to an end in one of three ways:

(i) A court order setting aside the resolution or order that commenced the proceedings or converting the proceedings to liquidation proceedings.[328]
(ii) A notice of termination filed by the practitioner with the CIPC as he or she is of the opinion that the company is not financially distressed or that there is no reasonable prospect of rescuing the company.[329]
(iii) A business rescue plan has either been substantially implemented (as confirmed in a filed notice by the practitioner) or rejected without any further steps taken.[330]

It was rightly stated by ENS Africa in the highlights article in the *INSOL international news update*[331] that the business rescue practitioner has at his or her disposal three primary tools not available to directors of an ailing company or its financiers. Firstly, the company under supervision enjoys a moratorium on claims by creditors. Secondly, the practitioner may suspend contractual obligations to which the company was a party at the commencement of the business rescue which become due during his or her supervision. Thirdly, the business rescue is meant to culminate in the adoption of a plan voted on by affected persons, which plan should provide a flexible solution for the company.

328 Section 132(2)(a).
329 Section 132(2)(b).
330 Section 132(2)(c).
331 ENS Africa “South Africa's new business rescue law - the courts' view” 2012 *Insol International News Update* 12.

### 3 6 Conclusion

This chapter considered the various requirements to commence business rescue, the difficulties that are being experienced in terms thereof and whether it is an improvement on judicial management. The new business rescue proceedings presented the legislature with an opportunity to design a rescue procedure that would avoid all the difficulties and flaws that had been identified in case of judicial management.

Business rescue proceedings begin either by means of a resolution of the board of directors of the company[332] or through successful application to the High Court by an affected person.[333] The gateway into a rescuing regime is of fundamental importance and has been made easier, compared to judicial management.[334] Commencement of business rescue by a board resolution is a substantively non-judicial, commercial process which provides for an uncomplicated, quick and inexpensive way to commence business rescue. The fact that the voluntary entry into business rescue occurs by the mere passing of a section 129 resolution, reflects the legislature's intention to make rescue and restructuring an easier mechanism to secure a "fresh start" and to support a shift to a more debtor-friendly approach.[335] This has been a much-needed improvement and business rescue has been made much more accessible than judicial management where the court had to be approached at least twice for an order commencing judicial management.[336]

In order to commence business rescue, a company must be financially distressed, which means that it must show commercial insolvency or actual insolvency within the next six months, which is in line with international tests for entry into the rescue process.[337] A number of criticisms can be levelled at the "financially distressed" requirement, such as the six-month period being too short, the fact that all parties will not have access to information required to prove the requirement and the fact that the Act does not include circumstances in which a company will be deemed to be

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332 Section 129.
333 Section 131.
334 See chapter 3 par 3 3 1.
335 See chapter 3 par 3 3 1 and Levenstein 635.
336 See chapter 2 par 2 2 1, 2 2 2 and 2 4 2 above for a discussion of the court proceedings to commence judicial management and the difficulties that were encountered with it.
337 See chapter 3 par 3 4 1.

financially distressed.[338] However, it is clear from the discussions above[339] that a company does not have to be in an extremely dire position, as was the case with judicial management, to commence business rescue proceedings where expected or imminent insolvency or illiquidity needs to be proved. This is a vast improvement by the legislature.

It is regrettable that the legislature failed to provide a better indication of what is required to prove a reasonable prospect of rescuing a company, especially taking into consideration the problems that existed with judicial management. The clarification of the test for what constitutes a "reasonable prospect" will serve to create a better understanding for assessment of entry levels into a rescue process.[340] Although the legislation does not assist with a clear and precise definition of such term, certain judgments have attempted to clarify the meaning of a "reasonable prospect".[341]

"Rescuing the company" means that the company can continue on a solvent basis or that the proceedings will result in a better return to creditors and shareholders than liquidation. The reference to the company continuing in a state of solvency shows some similarity to judicial management which required proof that there was a reasonable probability that the company would be able to pay all its debts and become a successful concern. The word "probability"[342] has been replaced by "possibility"[343] and business rescue makes provision for an alternative goal, namely, a better return for creditors or shareholders than liquidation, which was not available under judicial management. This goal recognises that the sale of a business as a going concern, for instance, may be more beneficial than liquidation.

In case of an application to court for the commencement of business rescue, the financially distressed requirement can be substituted by non-payment by a company of amounts due in respect of contractual or statutory obligations or when it would be just and equitable for financial reasons. The non-payment of an amount applies even

338 See chapter 3 par 3 4 1.
339 *Ibid.*
340 See chapter 3 par 3 4 2.
341 A detailed discussion of these cases is found in chapter 4 below.
342 In case of judicial management.
343 In case of business rescue.

if only one payment is missed, which could be as a result of other reasons which do not relate to financial difficulties. I agree with Loubser[344] that non-payment should occur over a stipulated minimum period or frequency before it constitutes a ground for rescue proceedings and that at least two consecutive payments should be missed. The "just and equitable for financial reasons" requirement is very vague and similar to the just and equitable requirement contained in the 1973 Companies Act to commence judicial management.[345]

Although a few uncertainties remain, the business rescue provisions contained in the 2008 Companies Act have vastly improved on the previous corporate rescue mechanism that was available to South Africa, being judicial management, and show a clear objective of rescuing companies that are able to be rescued instead of liquidating them.

344 Loubser 2010 *TSAR* 510; see chapter 3 par 3 4 4.
345 See chapter 3 par 3 4 5.

# CHAPTER 4
# DEVELOPMENT OF SOUTH AFRICAN CASE LAW IN RESPECT OF REQUIREMENTS TO COMMENCE BUSINESS RESCUE

## 4 1 Introduction

The requirements to commence business rescue are of particular importance for purposes of this dissertation and the manner in which these requirements are interpreted and implemented is important for companies, affected persons and the economy as a whole. It is submitted that if the provisions of chapter 6 of the 2008 Companies Act are interpreted and implemented too strictly without balancing the rights of affected persons it would render the business rescue regime no more successful than its predecessor, namely, judicial management.

Although the cases discussed in this chapter are not exhaustive of all the cases that have dealt with the business rescue provisions of the 2008 Companies Act, they are typical examples of the cases relating to business rescue and focus on the courts' interpretation of the various requirements to commence business rescue proceedings.

This chapter contains an analysis of some of the most influential South African cases on the requirements to commence business rescue. The cases have been arranged in the order in which they were decided as it is important to follow the initial interpretations of the various requirements by our courts and how the interpretations developed during the first few years after the new business rescue process came into effect.

## 4 2 Analysis of case law regarding requirements for business rescue

### 4 2 1 *Swart v Beagles Run Investments 25 (Pty) Ltd*[346]

This was probably the first reported judgment on the requirements for a successful business rescue application in terms of section 131 of the 2008 Companies Act. Swart, the sole director and shareholder of the respondent company, applied on an urgent basis to place the company under supervision and to commence business

[346] 2011 5 SA 422 (GNP).

rescue proceedings in terms of section 131(4)(a). Swart submitted that the company was solvent but financially distressed as it could not pay its debts in the ordinary course of business and needed time to dispose of movable assets. The court accepted that the company was financially distressed.

Makgoba J referred to business rescue as "a new innovation and without precedent in our law"[347] but then, incorrectly in my opinion, sought assistance in section 427 of the 1973 Companies Act to determine whether the company would be able to become a successful concern. The court, referring to authorities relating to judicial management under the 1973 Companies Act, held that it must be reasonably possible that the company is viable and capable of ultimate solvency and that it, within a reasonable time, would be able to effectively carry on its operations in accordance with its main object and yield a return to its shareholders and creditors. It is unfortunate that this reference to section 427 of the 1973 Companies Act was made as the 2008 Companies Act does not contain the words "successful concern" as part of the requirements in its business rescue provisions.[348]

The court further held that it has a discretion, even if it is found that the requirements set out in section 131(4)(a)(i) to (iii) had been met, to refuse to order supervision or business rescue. The court ultimately found that, in weighing-up the interests of creditors and the company, the interests of the creditors should be decisive. The application for business rescue was dismissed as there was "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".[349]

Although this case categorically dealt with business rescue proceedings, the court followed a conservative approach to the process,[350] and it is regretful that the court referred to requirements concerning judicial management.

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347 Par 23.
348 See also Meskin par 18.1 and Henochsberg 449 in this regard.
349 Par 42.
350 Joubert 2013 *THRHR* 446.

### 4 2 2 *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Limited*[351]

The respondent owned an uncompleted luxury hotel and was part of a group of several companies, most of which had already been placed under business rescue voluntarily. The respondent, along with other companies in the group, was funded by way of capital raised from members of the public through prospectuses and debentures. The applicant acquired *locus standi* by purchasing another creditor's claim and submitted that the respondent could become a successful concern if allowed to complete the hotel.

The court noted that the term "reasonable probability", as it appears in section 427 of the 1973 Companies Act, is different from the language employed in section 131(4) of the 2008 Companies Act, being "reasonable prospect", and that it indicated that something less was required than a reasonable probability that the company could be rescued, as was the case with judicial management.[352] It was further noted that the 2008 Companies Act reveals a clear preference for business rescue as opposed to liquidation but that caution should be exercised against the abuse of the temporary moratorium to serve the ulterior motives of directors or other stakeholders.[353] It must be shown by the applicant that the purpose of the business rescue is to achieve the aims of the statutory remedy, as opposed simply to evade creditors.

Eloff AJ stated that whilst every case must be considered on its own merits, it is difficult to conceive of a business rescue plan in a given case that will have a reasonable prospect of returning the company to continuing on a solvent basis, unless concrete and ascertainable facts are given which address the following:[354]

(i) the cause of the company's failure;
(ii) the likely costs of rendering the company able to proceed with its business activities (or intended business activities);

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351 2012 2 SA 423 (WCC).
352 See Henochsberg 458 and Meskin par 18.1 in this regard.
353 See Levenstein 291 for a further discussion on this case and more specifically the prevention of abuse of the business rescue process.
354 Par 24.

(iii) the likely available cash resources to enable the company to meet its daily operational costs;
(iv) the availability of any other necessary resources depending on the type of company (such as raw material and employees); and
(v) the reason why the applicant submits that the suggested business plan has prospects of rescuing the company.

A business rescue plan, according to Eloff AJ, which is unlikely to achieve anything more than prolonging the agony by, under these circumstances, substituting one debt for another without there being light at the end of a not too lengthy tunnel, is unlikely to suffice. The court dismissed the business rescue application and granted a provisional winding-up order.

It is submitted that the test applied in this case was too stringent and that it would be unfair to expect that a business rescue plan should be presented by all applicants as all affected persons do not readily have the type of information available to them to assess whether they would be able to comply with the requirements of section 131(4)(a).[355] Meskin[356] submits that a distinction must be drawn between the position where the board adopts a resolution to place a company under supervision under section 129(1) and that where an affected person brings an application to place the company under supervision under section 131.

The business rescue practitioner is expected to express an opinion at various stages of the business rescue procedure as to whether there still is a reasonable prospect of rescuing the company. Meskin submits[357] that the requirements postulated in *Southern Palace* would be better suited when applied to the circumstances where the business rescue practitioner is required to express an opinion as to whether or not there is a reasonable prospect of rescuing the company.

355 For further criticism see Levenstein 340 and Meskin par 18.4.3.
356 Meskin par 18.4.3.
357 *Ibid*.

### 4 2 3 *Koen v Wedgewood Village Golf & Country Estate (Pty) Ltd*[358]

The applicants were the purchasers of a stand on a vacant plot in Port Elizabeth on which the respondent was developing a golf estate. The respondent, due to an apparent lack of investment, was unable to sustain its development operations. The applicants submitted that there were reasonable prospects that the development (and the respondent) could be rescued as the Port Elizabeth market was expected to recover. It further contended that an investor was being actively pursued to further invest in the development, without providing any particulars of the potential investor.

The court held that the information needed to prove that there is a reasonable prospect of the company being rescued, will depend on the objective of the proposed rescue,[359] being either to achieve the continued existence of the company on a solvent basis or to allow its affairs to be managed on an interim basis so that creditors or shareholders will be better off compared to immediate liquidation. The court further held that in order to succeed in the application, whatever the object of the proposed business rescue, 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".[360] Levenstein submits[361] that the court adopted a modern (international) corporate rescue approach of focusing on whether or not the entity would continue to have a value as a going concern if it were to be rescued, compared to the recovery in a liquidation.

Binns-Ward J pointed out, correctly in my opinion, that it is the task of the business rescue practitioner 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 plan was implemented, or that the plan will enable creditors and shareholders to receive a better return from the rescue than would be the case in liquidation. However, he stated further that the applicants must convince the court that there is some viable basis upon which the practitioner will be able to undertake his or

358 2012 2 SA 378 (WCC).
359 Par 17.
360 *Ibid*.
361 Levenstein 341.

her task or that there is at least sufficient potential to justify the appointment of a practitioner to investigate the prospect.

As to the nature and type of information required to satisfy the court of the required details, the court agreed with the requirements set out in *Southern Palace* of some concrete and objectively ascertainable detail going beyond mere speculation. The court quoted the factual elements listed in paragraph 24 of *Southern Palace* and reiterated the need to indicate on which of the two possible objectives the applicant relies and to establish a factual basis accordingly. Binns-Ward J specifically stated that a "vague and speculative averment"[362] will not be enough to convince the court that a reasonable prospect exists that the company can be rescued, and the applicant will need to provide concrete and objectively ascertainable facts beyond speculation in the case of a trading or prospective trading company. The business rescue application was dismissed.

### 4 2 4 *AG Petzetakis International Holdings Limited v Petzetakis Africa (Pty) Ltd*[363]

The applicant was a shareholder of the respondent. The court confirmed that the respondent was clearly financially distressed with assets valued at approximately R60 000 000 and liabilities amounting to R225 000 000. The respondent ceased trading in 2010 and had not paid its employees since middle 2011. There had also been a failed attempt to compromise the debt of the respondent prior to a liquidation application brought against it.

The court echoed the importance of evidence to support a conclusion that there is a reasonable prospect that the company would be able to recover and continue its business and held that if an achievable draft rescue plan, with substantial support, is provided at the time of the application, the prospects of a successful application is substantially improved. However, the court however confirmed that the absence of such a business rescue plan at the time of the application is not necessarily fatal to the application. The prerequisites for an order placing a company under supervision

362 Par 20.
363 2012 5 SA 515 (GSJ).

and commencing business rescue proceedings are that one of section 131(4)(i), (ii) or (iii) must be fulfilled, and the court should also be satisfied that a reasonable prospect of rescuing the respondent exists. The reasonable prospect must be present, irrespective of which of the three subsections are applicable.

With regard to the "better return" objective, the court stated that the formulation of the 2008 Companies Act leaves some doubt as to whether it can be used, at the outset, to support an application for business rescue.[364] Coetzee AJ stated that it is odd to specify the objective or purpose of a remedy in a definition section and that once a company is under business rescue, the business rescue plan may be aimed at the alternative object, namely, a better return for creditors compared to the return which would be achieved in liquidation proceedings. It was held that

> "before a court can make the rescue order which would give rise to the practitioner's opportunity to work out a rescue plan it must be satisfied that there is a reasonable prospect of rescuing Petzetakis Africa or . . . that there is a prospect that the future rescue plan will achieve the alternative object of s 128(*b*)(iii), namely a better result than immediate liquidation".[365]

The court held that, even if assuming that this was an independent alternative object, there was no evidence comparing the business rescue scenario with that of liquidation and a provisional winding up order was granted.

### 4 2 5 *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kayalami) (Pty) Ltd*[366]

The applicants were the holders of 40% shares in Farm Bothasfontein. The applicants did not seek the rehabilitation and continued existence of the company, but envisaged that the business rescue practitioner would be able to sell the immovable property in the open market, thus basing their application on the secondary objective of business rescue, being a better return for creditors or shareholders than can be achieved in liquidation.

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364 See Henochsberg for further discussions in respect of this case and the "better return" objective.
365 Par 26.
366 2012 3 SA 273 (GSJ).

It was common cause that the company was financially distressed. The meaning of "reasonable prospect" was dealt with and the court concurred with the court in *Southern Palace* that something less is required in terms of the 2008 Companies Act than in the 1973 Companies Act. The court referred to its discretion to grant a business rescue application if facts were present indicating that there was a "reasonable possibility" of rescuing the company. The court referred to Loubser[367] who stated that the use of the judicial management test of "reasonable probability" would be disastrous if used in the business rescue process.[368] It is worth noting that the court referred to "possibility" instead of "prospect", which, according to Joubert,[369] strengthens the recommendations made by Loubser[370] that the 2008 Companies Act should refer to "possibility" instead of "prospect".

The court held that the general aim of business rescue is to preserve the value of a company's business as a going concern, to prevent job losses and the negative social effects of liquidation and that business rescue must be given preference. Different considerations applied in this case as the company had no employees or business to save and it was held that in such circumstances the interests of creditors should carry more weight than those of the company. No factual evidence was presented to indicate that a liquidator would be less successful than a business rescue practitioner in realising the property. The court refused the business rescue application and held that liquidation was more appropriate.

### 4 2 6 *Gormley v West City Precinct Properties (Pty) Ltd, Anglo Irish Bank Corporation Ltd v West City Precinct Properties (Pty) Ltd*[371]

The applicant was a shareholder and director of the respondent company which owned sectional title units which were mortgaged to the bank and rented out by the company. As further security, the rental income was ceded to the bank. The applicant submitted that the company would be able to meet its monthly obligations if it could obtain a moratorium for three to five years in respect of repayments to the bank.

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367 Loubser 2010 *TSAR* 506.
368 See also Levenstein 343 in this regard.
369 Joubert 2013 *THRHR* 557.
370 Loubser 339.
371 2013 JDR 1895 (WCC).

The court emphasised the fact that business rescue should apply only to companies that are "financially distressed" as defined in section 128(1)(f). Traverso DJP stated:[372]

> "It must either be unlikely that the debts can be repaid within 6 months or that there is the likelihood that the company will go insolvent within the ensuing 6 months. In this case the company is presently insolvent and cannot pay its debts unless a moratorium of 3-5 years is granted. The facts of this matter does [sic] not bring West City's financial situation within the definition of *'financially distressed'.* That should, in my view, be the end of the matter."

The court noted that the Act envisages a short-term approach to the financial position of a company for self-evident reasons and that "[t]here must be a measure of certainty in the commercial world. Creditors cannot be left in a state of flux for an indefinite period".[373] On the facts, the court found the company in question to be so insolvent that it did not fall within the definition of "financially distressed".

It was further held that using business rescue for the sole purpose of obtaining a moratorium is insufficient, as that would allow abuse of the process in order to frustrate the rights of creditors. The court held that the restructuring of the company was required and as such a restructuring plan was required even though it did not have to be detailed at the application stage. It was further held that the application must deal with the consequences should the restructuring fail.

The court took into account the intention of a creditor to vote against the plan and stated that the business rescue would be an exercise in futility as the bank, holding more than 75% of the voting interest, would no doubt vote against the plan. The business rescue application was dismissed and the company was provisionally liquidated.

372 Par 11 and 12.
373 Par 11.

### 4 2 7 *Nedbank Limited v Bestvest 153 (Pty) Ltd; Essa v Bestvest 153 (Pty) Ltd*[374]

The respondent owned a valuable piece of commercial property which it sought to develop and had already erected a building, which was financed, thereon. The respondent was under-capitalised for the project and experienced some cash-flow difficulties. During November 2010 the construction on the site came to a standstill and had not commenced again prior to the application.

The court held that an application for business rescue must set out sufficient facts, if necessary augmented by documentary evidence, from which a court would be able to assess the prospects of success before exercising its discretion that it has in terms of section 131(4).[375] In this matter, the respondent was not a trading company and its only asset was an incomplete building. The court commented that, ideally under the circumstances, one would expect such an application to set out:

(i) Brief reasons for the company's commercial insolvency;
(ii) the reasonable cost of bringing the building to completion, making it commercially viable;
(iii) the prospects of raising the finances required to so-complete the building; and
(iv) how best, once completed, the building can attain commercial viability by, for example, developing it as a sectional title scheme, or letting to commercial and/or residential tenants or selling it.

The court held that the words "reasonable prospect" have the same meaning in both section 129 and section 131, in that the board (in case of section 129(1)) or the applicant (in case of section 131(4)) would have to meet this requirement prior to adopting a business rescue resolution or prior to obtaining a court order placing the company under supervision. Although the board will not have to convince the court that there is a reasonable prospect of rescuing the company at the time the resolution is adopted, it may well have to do so should an affected person apply to court under section 130 to have the resolution set aside on the grounds that there is no reasonable prospect of rescuing the company.

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374 2012 5 SA 497 (WCC).
375 See also Meskin par 18.4.3 and Levenstein 344 where this case was discussed.

### 4 2 8 *Employees of Solar Spectrum Trading 83 (Pty) Ltd v Afgri Operations Limited*[376]

The employees of the company sought an order placing the company under business rescue. This was the first case since the inception of the new business rescue procedure where employees, as affected persons, approached a court to apply for a company's compulsory business rescue.

The court commenced by stating that care must be taken in balancing the weight and consideration to be given to various competing interests and to guard against the use of business rescue proceedings in situations where they are clearly not warranted. The court held that it must ultimately be satisfied that reasonable prospects do exist, and in the balancing exercise it must have regard to what information the affected party who brings the application is able to present given its own position *vis-à-vis* the company. To illustrate this point, the court distinguished between a shareholder and an employee, stating that a shareholder is likely to possess greater detail of a company's financial position and its financial performance and, an employee on the other hand, would have peculiar information of a company's performance being at the centre and the heart and soul of its operations.[377]

The court held, expressly without suggesting that different tests should be applied in establishing whether the threshold of a reasonable prospects had been met, that

> "if the Act is to be implemented in a manner that does not disadvantage an employee as an affected party, then regard must be had both in assessing whether there are reasonable prospects and in exercising of the balance of competing rights to the different positions of the parties in relation to the company".[378]

In his explanation of the meaning of the word "prospect", Kollapen J referred to the uncertain nature of the word and stated that "[b]y 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".[379] He concluded by

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376 Unreported case no (6418/2011, 18624/2011) [2012] ZAGPPHC 359 (16 May 2012).
377 See also Henoschsberg 480(3) for further criticism in this regard.
378 Par 17.
379 Par 33.

stating that what is required is a determination that the future prospects of rescuing the business appear to be reasonable.

The court confirmed that it should not in every case be expected of an applicant in business rescue proceedings to produce a business rescue plan. It is ultimately the duty of the business rescue practitioner, should he be appointed, to compile such a plan, if any.

In referring to the major creditors' intention to vote against a future plan, Kollapen J stated the following:

> "Whatever the position of the first respondent may be and while its cynicism may be justified at some level I would imagine that at the very least there would be an obligation on it to participate in good faith and to consider on its own merits or demerits any business plan proposed. I cannot imagine that it can be contended that it is a foregone conclusion that it will vote against the business plan even before one has been developed."[380]

The court was of the opinion that the employees made out a reasonable prospect that the business may be rescued and granted the application for the commencement of business rescue proceedings.

### 4 2 9 *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Limited*[381]

The respondent company was not successful in developing certain property and a creditor applied for the company to be placed in business rescue. The property, with substantial value, was the only asset of the respondent who had no employees. There was no proper valuation of the property before the application was heard. The "business rescue plan" was effectively to sell the developed property. Prior to the application, the respondent was unable to sell any of the developed erven.

The court looked at the meaning of the phrase "reasonable prospect" in section 131(4)(a). In order to define this phrase, the court started by looking at the meaning

380 Par 36.
381 2013 1 SA 542 (FB).

of the term “rescuing the company” and in doing this, Van der Merwe J confirmed that “rescuing” could be accomplishing either one of the objectives contained in section 128(1)(h) of the Act.

The court agreed with the interpretation of Eloff AJ in *Southern Palace* who held that the 2008 Companies Act requires less than the 1973 Companies Act. The court held that a “reasonable prospect” in this context means a reasonable expectation and that “[a]n expectation may come true or it may not. It therefore signifies a possibility. A possibility is reasonable if it rests on a ground that is objectively reasonable”.[382] In the court’s judgment, a reasonable prospect meant no more than a possibility that rests on an objectively reasonable ground or grounds. The court consequently dismissed the application to place the respondent under supervision and to commence business rescue proceedings.

The court did not deem it appropriate to create a check list of basic information that would satisfy the reasonable prospect requirement and remarked that the court in *Southern Palace* expected too much of the applicants in order to prove that a reasonable prospect existed. The court stated that “a factual foundation for the existence of a reasonable prospect that the desired object can be achieved”[383] must be placed before the court in a business rescue application.

### 4 2 10 *Zoneska Investments (Pty) Ltd t/a Bonatla Properties (Pty) Ltd v Midnight Storm Investments 386 Ltd*[384]

The court had to consider whether to grant the winding-up of the respondent company at the instance of an intervening creditor or to commence business rescue at the instance of another creditor (Bonatla).

The basis for Bonatla’s application was that there was a reasonable prospect of rescuing the company in the sense of continuing with the development of the company’s property with the objective of a greater return to creditors and shareholders, as com-

382 Par 12.
383 Par 11.
384 2012 4 SA 590 (WCC).

pared to the winding-up of the company. The company's only asset, a development, was valued at R120 000 000.

The court interpreted "prospect" to mean "possibility" and stated that the facts put before the court cannot comprise of speculative suggestions. However, there cannot be a "check list approach" and the applicant must set out sufficient facts from which a court would be able to assess the prospects of the rescue plan succeeding in meeting its objective before the court can exercise its discretion. This, according to the court, would include an enquiry into the practical feasibility of the plan.

The court held that the question must be whether the applicant, on the common cause facts of the matter, and where there is a real dispute of facts, on the respondent (or intervening creditor's) version, has shown that there is a reasonable prospect of "rescuing the company" in the sense that acceptance and implementation of the plan, upon which the applicant relies, has a possibility, based on objective facts, that it will result in a better return for the company's creditors and shareholders than the result achieved in the winding-up of the company. The business rescue application was dismissed.

### 4 2 11 *Newcity Group (Pty) Ltd v Pellow, China Construction Bank Corporation Johannesburg Branch v Crystal Lagoon Investments 53 (Pty) Ltd*[385]

Newcity was the sole shareholder and a creditor of Crystal Lagoon and applied that Crystal Lagoon be placed under supervision in terms of section 131 of the 2008 Companies Act.

The court stated that section 7(k) requires a court to balance the rights and interests of relevant stakeholders and that the Act makes it clear that business rescue is preferred to liquidation.

With reference to section 131(1), Van Eeden JA held that each of the jurisdictional requirements in section 131(1)(i), (ii) and (iii) is qualified by a further and thus overriding requirement, namely, that there is a reasonable prospect of rescuing the com-

385 [2013] JOL 30622 (GSJ).

pany and that, regardless of which jurisdictional requirement is present, in each instance there must also be a reasonable prospect of rescuing the company. It was, however, noted that it seems unnecessary and impossible to require it in respect of subsection (ii) and Van Eeden JA stated that it remains to be seen how the absence of a "reasonable prospect for rescuing the company" will derail an application for business rescue based on jurisdictional requirement (ii).

It was shown that Crystal Lagoon was financially distressed and that the requirement set out in section 131(1)(i) was met.

The court referred to the conflicting views on how a court should determine whether there is a reasonable prospect for rescuing the company and stated that Eloff AJ in *Southern Palace* gave a judgment on the complex problem of applications for business rescue when he had little, if any, precedent to follow while Van der Merwe J in *Prospec Investment* felt that this line of reasoning placed the bar too high.[386]

The court held that it is not a requirement that an applicant should attach a business rescue plan to its founding affidavit. However, the application should be based upon a strategy that has a reasonable prospect of achieving one of the two objects stated in section 128(1)(b)(iii) and if such a strategy is not advanced in the application, a court would hardly be satisfied that a reasonable prospect of rescuing the company exists.

Van Eeden JA made it clear that a company can only be rescued if there is a reasonable prospect based on facts, not speculation, and stated that "[i]f objectively there is a reasonable possibility or likelihood of those uncertain future events occurring, the jurisdictional requirements have been satisfied, and the court can exercise its discretion".[387]

Van Eeden JA further found that in some instances the modicum of evidence required will be less than in others, such as where the application is brought by some-

386 See Meskin par 18.4.3 for a further discussion of this case.
387 Par 14.

body without in-depth knowledge of the affairs of the company. According to Van Eeden JA, a suitable test "should be flexible and the circumstances of each case will determine whether viable facts give rise to a reasonable prospect or not"[388] and "speculation cannot create a reasonable prospect".[389]

The court held that speculation and the contention that third-party funding may still save Crystal Lagoon cannot be said to create the required reasonable prospect. It was further held that the biggest creditor was in favour of liquidation and a creditor would normally know best whether a better return would be achieved by business rescue or not. It was found that in this case balancing the rights and interests of these stakeholders requires that finality be reached and the company was placed in liquidation.

Joubert[390] submits that Van Eeden JA added value by indicating that the following would show whether a reasonable prospect exists: 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) 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).

### 4 2 12 *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd*[391]

This was the first case since the inception of business rescue proceedings in terms of Chapter 6 of the 2008 Companies Act that was decided by the Supreme Court of Appeal. It provides clarity on some important interpretational debates that have recently resulted in conflicting decisions by different High Courts.

It was not in dispute that the company was financially distressed as contemplated by the Act. The applicants argued that business rescue should be preferred over liquidation since the company was likely to realise more returns if its properties were sold

388 Par 24.
389 Par 23.
390 Joubert 2013 *THRHR* 562.
391 2013 4 SA 539 (SCA).

by a business rescue practitioner instead of a liquidator. The High Court dismissed the business rescue application and ordered the liquidation of the company. The applicants appealed to the Supreme Court of Appeal.

The Supreme Court of Appeal confirmed the decision of the court *a quo* and provided the following important clarifications on the interpretation of the law relating to business rescue and more specifically the requirements to commence business rescue proceedings:

(i) A registered holder of 40% of the shares in a company, despite its entitlement to those shares being in dispute, qualifies as an "affected person";[392]

(ii) the requirement in section 131(4), namely, that the company must be financially distressed, seems to turn on a question of fact;[393]

(iii) the question whether there is a reasonable prospect of rescuing the company can only be answered with "yes" or "no" and it involves a value judgment;[394]

(iv) "rescuing the company" means achieving either of the goals set out in the definition of "business rescue", the primary goal being to facilitate the continued existence of the company in a state of solvency and the secondary goal, which is provided for as an alternative, being that in the event that the achievement of the primary goal proves not to be viable, to facilitate a better return for the creditors or shareholders of the company than would result from immediate liquidation;[395]

(v) "reasonable prospect" is a lesser requirement than the "reasonable probability" which was the yardstick for placing a company under judicial management in terms of section 427(1) of the 1973 Companies Act but requires more than a mere *prima facie* case or an arguable possibility;[396]

(vi) the emphasis must not be on "prospect" alone, but rather on "reasonable", thus a "prospect based on reasonable grounds" set out by the applicant in the founding papers and a mere speculative suggestion is not enough;[397]

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392 Par 6.
393 Par 21.
394 Par 21.
395 Par 23.
396 Par 29.
397 Par 29.

(vii) it is neither practical nor prudent to be prescriptive about the way in which an applicant must show a reasonable prospect in every case and an applicant is not required to set out a detailed plan. That can be left to the business rescue practitioner after proper investigation in terms of section 141;[398]

(viii) business rescue is not intended to achieve a winding-up of a company to avoid the consequences of liquidation proceedings;[399]

(ix) the majority creditors' intention to oppose any business rescue scheme should not be ignored unless that attitude can be said to be unreasonable or *mala fide*, but in that case such rejection can be revisited by the court in terms of section 153.[400]

In terms of the principle of *stare decisis*, a decision of the Supreme Court of Appeal is binding on all lower courts, and this decision will go a long way towards achieving some level of certainty in business rescue proceedings. According to Levenstein[401] this was a seminal case in the context of business rescue and confirmed an interpretation of business rescue that embraces the protection of creditors whilst confirming the shift away from the more traditional creditor-oriented insolvency procedures.

### 4 2 13 *Newcity Group (Pty) Ltd v Pellow*[402]

This is an appeal against the court *a quo*'s dismissal of Newcity's application to place Crystal Lagoon under supervision and commencing business rescue proceedings. The court granted a final winding-up order of Crystal Lagoon.

The crisp question in this matter was whether Newcity established grounds for the reasonable prospect of restoring Crystal Lagoon to solvency or, if that was impossible, to provide a return for creditors and shareholders which could be better than the return that would be received if Crystal Lagoon were to be wound-up.

398 Par 30 and 31.
399 Par 33.
400 Par 38.
401 Levenstein 612.
402 [2015] JOL 33538 (SCA).

The court confirmed that the mere savings in the costs of the winding-up process in accordance with the existing liquidation provisions does not justify the institution of business rescue proceedings.

The court further confirmed that the "reasonable prospect" requirement requires more than a mere *prima facie* case or an arguable possibility but, notably, less than a reasonable probability. In deciding whether there is a reasonable prospect, the court exercises a discretion in the wide sense – it makes a value judgment – and if a court of appeal should disagree with the conclusion, it is bound to interfere.

The court held that, bearing in mind that CCBC is its majority creditor holding in excess of 75% of its independent creditor's voting interests, envisaged in section 128(1)(j) and 145(4), (5) and (6) of the Act, Newcity had failed to establish a prospect based on reasonable grounds that business rescue would return Crystal Lagoon to solvency or provide a better deal for its creditors and sole shareholder than what they would receive through liquidation.

**4 3 Conclusion**

Our courts started off with a questionable approach to the business rescue provisions, with the first reported case[403] mistakenly referring to authorities relating to judicial management and stating that the company should be capable of ultimate solvency and creditors' interests should take preference. The court did not consider the second objective, namely, a better return for creditors or shareholders, nor did it take into account section 7(k) which requires the rights and interests of all stakeholders to be balanced.

However, this questionable approach changed as several judgments outlined the distinction between the approaches taken by the courts in relation to business rescue as opposed to judicial management. It is clear from the judgments that something less, being a reasonable prospect, is required in respect of business rescue as opposed to judicial management proceedings, which required a reasonable probabil-

403 *Swart* as discussed in par 4 2 1 *supra*.

ity that the company could be rescued.[404] This was confirmed by the Supreme Court of Appeal in *Oakdene Square*.[405] Although a clear preference is noted in favour of business rescue as opposed to liquidation proceedings,[406] concrete and ascertainable facts must be furnished[407] in the application as vague and speculative averments will not suffice.[408]

It was held that "reasonable prospect" meant no more than a possibility[409] that rests on objectively reasonable grounds,[410] and that the facts put before the court cannot comprise of speculative suggestions.[411] The Supreme Court of Appeal in *Oakdene*[412] held that the "financially distressed" requirement turns on a question of fact while the question whether there is a reasonable prospect of rescuing the company involves a value judgment.[413]

The bar was initially set very high, as Eloff AJ[414] required a business rescue plan to be presented together with the business rescue application. However, it was later held that the absence of such a business rescue plan is not necessarily fatal to the application,[415] and that it should not in every case be expected of an applicant in business rescue proceedings to produce a business rescue plan,[416] although the prospects of a successful application are substantially improved should a plan be presented.[417] There cannot be a "check list approach",[418] and one must have regard to what information the affected party who brings the application is able to present, given its own position *vis-à-vis* the company, in order to balance the weight and con-

404 *Southern Palace* as discussed in par 4 2 2; *Oakdene Square* as discussed in par 4 2 5; *Prospec Investment* discussed in par 4 2 9; *Newcity Group* discussed in par 4 2 13.
405 See the discussion in par 4 2 2.
406 *Southern Palace* discussed in par 4 2 2; *Oakdene Square* discussed in par 4 2 5.
407 *Southern Palace* discussed in par 4 2 2.
408 *Koen* discussed in par 4 2 3*; Newcity Group* discussed in par 4 2 11; *Oakdene Square* discussed in par 4 2 12.
409 *Zoneska Investments* discussed in par 4 2 10.
410 *Prospec Investment* discussed in par 4 2 9.
411 *Zoneska Investments* discussed in par 4 2 10.
412 See the discussion in par 4 2 12.
413 See also the discussion in par 4 2 13 where this was confirmed by the *Newcity Group* appeal case.
414 *Southern Palace* discussed in par 4 2 2.
415 *AG Petzetakis* discussed in par 4 2 4.
416 *Employees of Solar Spectrum* discussed in par 4 2 8; *Newcity Group* discussed in par 4 2 11.
417 *AG Petzetakis* discussed in par 4 2 4.
418 *Zoneska Investments* discussed in par 4 2 10.

sideration to be given to various competing interests.[419] It is clear that every case must be considered on its own merits[420] and a suitable test should be flexible and the circumstances of each case will determine whether or not viable facts give rise to a reasonable prospect.[421] The issue of whether an applicant is required to attach a business rescue plan to its application was resolved by the Supreme Court of Appeal[422] as it held that it is neither practical nor prudent to be prescriptive about the way in which an applicant must show a reasonable prospect in every case and that an applicant is not required to set out a detailed plan.

It was further noted in certain judgments that the objective of business rescue, which could be accomplishing either of the objectives contained in section 128(1)(h),[423] will determine the information needed to prove that there is a reasonable prospect of the company being rescued and that the application should clearly indicate on which of the two possible objectives the applicant relies.[424] Earlier cases indicated that a company that was already insolvent could not commence business rescue proceedings,[425] while later judgments held that the fact that a company was already insolvent did not automatically disqualify it from business rescue proceedings, but that it was something that needed to be taken into account when considering the "reasonable prospect" requirement.[426]

The high bar that was set by Eloff AJ in *Southern Palace* created some uncertainty as most decisions dealing with the reasonable prospect requirement referred to the guidelines provided by Eloff AJ. Even though the requirements are not precisely the same, the problems and uncertainty experienced in respect of the "reasonable probability" requirement were one of the main reasons judicial management failed as a successful corporate rescue mechanism. A clear definition of the recovery requirement has not yet been developed by the courts, but the bar has been lowered by lat-

419 *Employees of Solar Spectrum* discussed in par 4 2 8.
420 *Southern Palace* discussed in par 4 2 2.
421 *Newcity Group* discussed in par 4 2 11.
422 *Oakdene Square* discussed in par 4 2 12.
423 *Prospec Investment* discussed in par 4 2 9; *Newcity Group* discussed in par 4 2 2 11; *Oakdene Square* discussed in par 4 2 12.
424 *Koen* discussed in par 4 2 3; *Newcity Group* discussed in par 4 2 11.
425 *Gromley* discussed in par 4 2 6.
426 *Southern Palace* discussed in par 4 2 2; *Newcity Group* discussed in par 4 2 13.

er judgments, including the Supreme Court of Appeal judgment,[427] which showed a more versatile approach.

It is clear from the discussion above that the uncertainty experienced by the courts regarding the meaning of "reasonable prospect" is one of the most problematic issues encountered in respect of the business rescue provisions, and the clarification of the test of what constitutes a reasonable prospect will create a better understanding of the assessment of entry requirements into business rescue proceedings.

The fact that the courts show a preference for business rescue as opposed to liquidation is an indication that the law has moved from a creditor-friendly approach to an approach that seeks to balance the interests of all stakeholders in accordance with section 7(k) of the Act. However, the majority creditors' intention to oppose any business rescue proceedings should not be ignored unless that attitude can be said to be unreasonable or *mala fide*.[428] The courts nevertheless are not tolerating abusive or facetious business rescue applications and, although the test for meeting the minimum requirements remains flexible, parties are still required to identify and provide objectively reasonable prospects accompanied by concrete and ascertainable factual support.

The Supreme Court of Appeal in *Oakdene*[429] has provided clarity on some important interpretational debates that have resulted in conflicting decisions by different High Courts. However, there is still quite a long way to go before the organised profession completely gathers all the essentials, explores all the gaps of the 2008 Companies Act and lays or casts a well-covered path that would produce and ensure consistency in the implementation and interpretation of this new concept.[430]

Except for the first few cases, it does not seem as if the legacy of judicial management has caused the courts to apply the business rescue provisions too strictly. In fact, it seems that our courts are giving this new concept a reasonable chance in

427 *Oakdene Square* discussed in par 4 2 12.
428 *Ibid*.
429 Discussed in par 4 2 12.
430 *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd* 2013 JDR 1019 (GSJ) par 1.

cases where the concept is not clearly abused. It is submitted that our courts are interpreting and applying the business rescue provisions in such a way that there is a proper balance in the application of the requirements to prevent the abuse of business rescue proceedings, whilst not being too strict and cause business rescue proceedings to fall into disuse, as they are essential to achieve the purpose of the Companies Act of 2008 as set out in section 7 thereof.

# CHAPTER 5
# CONCLUSION

The dissertation mainly dealt with the requirements to commence business rescue and to evaluate whether this corporate rescue mechanism improved when compared to judicial management, whether it balances the rights of all affected persons and whether it is applied correctly by our courts or applied too strictly as a result of the legacy of judicial management.

Since 1926, when judicial management was introduced by the Companies Act of 1926, South African company law has provided for the rescue of financially distressed companies. As mentioned in the previous chapters, judicial management had several shortcomings which played a vital role in its failure. It is for this reason that it was important to look at the history of the South African corporate rescue mechanisms, more specifically the requirements to commence the proceedings, in order to compare the new business rescue provisions and ascertain whether our law has improved on the difficulties experienced in the past. Judicial management created a platform for the business rescue proceedings in that it gave an indication of what would and what would not work for a business in financial distress. Judicial management therefore was a good stepping stone for business rescue, providing the legislature with a foundation for business rescue in the 2008 Companies Act.

The current business rescue provisions replaced the judicial management provisions of the Companies Act of 1973 which, it is generally agreed, had seldom yielded positive results.[431] Hence, the 2008 Companies Act introduced a new business rescue procedure aimed at facilitating the rehabilitation of companies that are financially distressed. Business rescue commences either by means of a resolution of the board of directors of the company[432] or through successful application to the High Court by an affected person.[433]

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431 See chapter 2 par 2 4 for a discussion of the possible reasons why judicial management was unsuccessful.
432 See chapter 3 par 3 3 1.
433 See chapter 3 par 3 3 2.

This procedure is an improvement on judicial management as it is not necessary for the company to go through a court procedure, rendering it faster, easier and less expensive. Judicial management relied on the courts and the court had to grant a provisional[434] and then a final judicial management order[435] which was problematic due to the costs associated with approaching the courts as well as the time it took for the matter to be heard. This has been changed by the 2008 Companies Act, in that a board resolution can be filed without the need to apply to court, and should the court be approached, a final order can be granted instead of having to approach the court twice. The fact that business rescue may commence by the mere passing of a board resolution reflects the legislature's intention to make the process easy, viable and cost effective and supports a shift to a more debtor-friendly approach[436] which will encourage directors to address financial distress at an early stage.

Because the initiation of voluntary business rescue proceedings has been simplified and is inexpensive, it is open to potential abuse and the legislature therefore has sought to protect affected persons by making provision for them to approach the court in appropriate circumstances, and by attempting to balance the rights of all affected persons.[437]

In order to commence business rescue proceedings, a company must be financially distressed in that it must be anticipated that it will be commercially or factually insolvent within the immediately ensuing six months.[438] In the alternative, in the case of a court application, the court must be satisfied that 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,[439] or that it is otherwise just and equitable to do so for financial reasons.[440]

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434 The requirement for the court to grant a provisional judicial management was discussed in chapter 2 par 2 2 1.
435 See chapter 2 par 2 2 2 for a discussion on a final judicial management order.
436 See chapter 3 par 3 3 1.
437 See chapter 3 par 3 1 for a discussion of the purpose of the 2008 Companies Act and par 3 4 for the requirements that need to be met and circumstances in which the court may set aside a business rescue order.
438 See chapter 3 par 3 4 1.
439 See chapter 3 par 3 4 4.
440 See chapter 3 par 3 4 5.

It is clear from the discussions above[441] that a company does not have to be in an extremely dire financial position, as was the case with judicial management which required proof that the company was already unable to pay its debts,[442] before a judicial management order could be granted. This feature is a vast improvement by the legislature, when compared to the former process. The six-month period gives the company the opportunity to commence business rescue proceedings where there is only a possibility of distress, thus improving the company's chances of a successful rescue process.

It is submitted that the definition of "financially distressed" should be broadened to include circumstances in which a company will be deemed to be financially distressed, and that the period of six months stipulated in the test should be increased to twelve months, as financial planning of a company usually stretches over the next financial year.[443] It would make it easier for affected persons who do not have access to company records to prove that the company is financially distressed if there are specific circumstances mentioned in which a company will be deemed to be financially distressed.

An administrative or system failure experienced by a company could cause a company to fail to pay an amount in respect of employment-related matters. It is submitted that non-payment should occur over a stipulated minimum period or frequency before it constitutes a ground for rescue proceedings.[444]

The second alternative to the company being financially distressed, namely, that the court regards it as otherwise just and equitable for financial reasons,[445] is vague and similar to the just and equitable requirement to commence judicial management contained in the 1973 Companies Act.[446] It is submitted that this requirement contributed to judicial management being regarded as an extraordinary remedy[447] and it is rec-

441 See chapter 3 par 3 4 1.
442 See chapter 2 par 2 3 1 for a discussion on the requirement of an inability to pay debts.
443 See chapter 3 par 3 4 1.
444 See chapter 3 par 3 4 2.
445 See chapter 3 par 3 4 5.
446 See chapter 2 par 2 3 5.
447 See chapter 2 par 2 4 2 for a discussion of the strict application by our courts in respect of judicial management requirements.

ommended that, for purposes of business rescue, the circumstances should be listed in which a company would be deemed to be in financial distress.

In addition to the "financially distressed" requirement, there must be a reasonable prospect of rescuing the company. In order for a company to voluntarily commence business rescue proceedings, the board needs reasonable grounds to believe that there appears to be a reasonable prospect of rescuing the company. The application and meaning of the "reasonable prospect" requirement seem to be more or less the same for both the resolution by the board of the company and an application to court.[448] Should this be the case, it might prove to be problematic as the directors of a company and the affected persons will not necessarily have the same access to, and insight into, the company's affairs.[449]

It is unfortunate that, despite the abundant criticism regarding the "reasonable probability" requirement of judicial management,[450] the legislature did not provide a definition of "reasonable prospect" nor did it provide a clearly-formulated burden of proof.[451] Unfortunately, as set out in chapter four above, conflicting court decisions have not assisted in providing clarity in this regard.

The required circumstances in which a company may be placed under business rescue are not as onerous as those for judicial management with the test throughout being one of a reasonable belief or reasonable likelihood, rather than a probability. This was confirmed in various judgments as discussed in chapter four.

When considering the definition of "rescuing the company", the reference to the continued existence of a company in a state of solvency shows some similarity with the requirements for a judicial management order. The definition, however, does not state as its only objective the rescue of the company, but also the possibility of devising a plan, if the company cannot be rescued, that results in a better return for creditors or shareholders than the immediate winding-up of the company. The business

448 See chapter 3 par 3 4 2.
449 See chapter 3 par 3 4 2.
450 See chapter 2 par 2 3 3.
451 See chapter 3 par 3 4 2.

rescue concept recognises that another process, for instance the sale of a business as a going concern, may be more beneficial to creditors or shareholders than immediate liquidation proceedings.[452] This was not a factor which was considered by the courts in granting a judicial management order, as it was expected that creditors should receive payment of their full debt which was in conflict with modern principles of rescue. The excessively stringent requirement that there had to be a reasonable probability that the company would become a successful concern placed a heavy burden of proof on the applicant which was almost impossible to discharge.

Although our courts started off with a questionable approach, sometimes even applying judicial management principles and precedents, more recent judgments indicate a more flexible approach and a willingness to consider business rescue proceedings without setting the bar too high.

The failure of judicial management to function as a viable corporate rescue mechanism is to a large extent due to our courts' approach and limiting interpretation of the judicial management provisions. Judicial management has always been regarded by our courts as an extraordinary remedy which infringes on the rights of creditors and should only be available under extraordinary circumstances.[453] Courts in general preferred to grant a liquidation order, and hardly ever granted a judicial management order against a creditor's wish. There was no balance between the interests of different stakeholders.

Our courts have indicated a preference of business rescue over liquidation proceedings.[454] However, concrete and ascertainable facts must be furnished in the application,[455] as vague and speculative averments will not suffice.[456] A business rescue application may be based on any of the two objectives contained in section 128(1)(b)(iii).[457] Although some earlier judgments indicated that a business rescue

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452 See chapter 3 par 3 4 2.
453 See chapter 2 par 2 4 2.
454 *Southern Palace* discussed in par 4 2 2; *Oakdene Square* discussed in par 4 2 5.
455 *Southern Palace* discussed in par 4 2 2.
456 *Koen* discussed in par 4 2 3; *Newcity Group* discussed in par 4 2 11; *Oakdene Square* discussed in par 4 2 12.
457 *Prospec Investment* discussed par 4 2 9; *Newcity Group* discussed in par 4 2 11; *Oakdene Square* discussed in par 4 2 12.

plan had to accompany a business rescue application, it was later held that the absence of such a plan is not fatal to the application. The Supreme Court of Appeal[458] held that it is neither practical nor prudent to be prescriptive about the way in which an applicant must show a reasonable prospect in every case.

Our courts have held that the "financially distressed" requirement turns on a question of fact[459] and the fact that a company is already insolvent does not automatically disqualify it from business rescue proceedings. It is, however, something that needs to be taken into account when considering the "reasonable prospect" requirement.[460]

The uncertainty experienced by the courts regarding the meaning of "reasonable prospect" is one of the most problematic issues regarding the business rescue provisions. It is clear from the judgments that something less is required in respect of business rescue as opposed to judicial management proceedings, which required a reasonable probability that the company could be rescued.[461] It was held that "reasonable prospect" involves a value judgment[462] and means no more than a possibility[463] that rests on objectively reasonable grounds,[464] and not speculative suggestions.[465] A suitable test should be flexible and the circumstances of each case will determine whether viable facts give rise to a reasonable prospect or not.[466]

A clear definition of the "reasonable prospect" requirement has not yet been developed by the courts and the clarification of the test of what constitutes a reasonable prospect will create a better understanding of the assessment of entry requirements into business rescue proceedings.

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458 *Oakdene Square* discussed in par 4 2 12.
459 See the discussion in chapter 4 par 4 2 12.
460 *Southern Palace* discussed in par 4 2 2*; Newcity Group* discussed in par 4 2 13.
461 *Southern Palace* discussed in par 4 2 2; *Oakdene Square* discussed in par 4 2 5; *Prospec Investment* discussed in par 4 2 9; *Newcity Group* discussed in par 4 2 13; *Oakdene Square* discussed in par 4 2 12.
462 Also see the discussion in par 4 2 13 where it was confirmed in the *Newcity Group* appeal case.
463 *Zoneska Investments* discussed in par 4 2 10.
464 *Prospec Investment* discussed in par 4 2 9.
465 *Zoneska Investments* discussed in par 4 2 10.
466 *Newcity Group supra* note 235 par 24.

It is clear, from the fact that the courts show a preference for business rescue as opposed to liquidation, that the law has moved from a creditor-friendly approach to an approach that seeks to balance the interests of all stakeholders in accordance with section 7(k) of the Act. The majority creditors' intention to oppose any business rescue proceedings should, however, not be ignored unless that attitude can be said to be unreasonable or *mala fide*.[467]

The current change in approach by our courts can best be illustrated with reference to what Claassen J said in *Oakdene Square*:[468]

> "The general philosophy permeating the business rescue provisions is the recognition of the value of the business as a going concern rather than the juristic person itself. Hence the name 'business rescue' and not 'company rescue'. This is in line with the modern trend in rescue regimes. It attempts to rescue and balance the opposing interests of creditors, shareholders and employees. It encapsulated a shift from creditors' interest to a broader range of interest. The thinking is that to preserve the business coupled with the experience and skill of its employees, may, in the end prove to be a better option for creditors in securing full recovery from the debtor."

With the introduction of business rescue into South African law many feared that the process would be abused since it is a relatively simple process to file a resolution to commence business rescue proceedings. There are positive measures in the Act to combat abuse of process, in that the time constraints from the initiation of business rescue are fairly onerous, provision is made for the intervention by courts when companies unjustifiably use business rescue proceedings to the detriment of creditors, and the proceedings provide for a consultative and inclusive process involving all affected persons, in which each of these persons is afforded an opportunity to participate and be consulted throughout the process. The business rescue proceedings are debtor-friendly and concerned not only with repaying creditors, but also with protecting all affected parties by ensuring that their various interests are fairly balanced.

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467 *Oakdene Square* discussed in par 4 2 12.
468 *Supra* note 68 par 12.

Except for the first few cases, it does not seem as if the legacy of judicial management has caused the courts to apply the business rescue provisions too strictly. It is submitted that our courts are interpreting and applying the business rescue provisions in such a way that there is a proper balance in the application of the requirements to prevent the abuse of business rescue proceedings, whilst not being too strict and cause business rescue proceedings to fall into disuse, as they are essential to achieve the purpose of the Companies Act of 2008 as set out in section 7 thereof.

One of the issues that needs to be addressed is certainty as to what is expected from an applicant to prove that there is a reasonable prospect of rescuing the company. A number of criticisms can be levelled at the “financially distressed” requirement such as the six-month period being too short, the fact that all parties will not have access to information required to prove the requirement and the fact that the Act does not include circumstances in which a company will be deemed to be financially distressed. The non-payment by a company of amounts due in respect of contractual or statutory obligations should be amended to require the occurrence thereof over a stipulated minimum period or frequency, and “financial reasons” in the “just and equitable for financial reasons” requirement should be defined as it is very vague.

Despite possible shortcomings, as pointed out in this dissertation, business rescue is a significant improvement on judicial management and has been made much more accessible. It balances the rights of all affected persons in such a way that it prevents abuse of the proceedings, whilst not being too strict to cause the proceedings to fall into disuse.

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