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## ARTICLE: BUSINESS RESCUE AS OPPOSED TO LIQUIDATION

*"We must be honest enough to admit the depth of the political, economic and social challenges our country faces. And we must be courageous enough to recognise the domestic and global conditions that give rise to these challenges"*

*(By Deputy President Cyril Ramaphosa 2018)*

The above quotation is a depiction of the world's current economic condition. Some companies have high debts and as a result may be exposed to more financial risk. A company is a fundamental part of the community in which it does business and it has a direct impact on the economic and the social welfare of that community. Thus liquidation is an extreme measure, therefore, it is necessary to have legislation that is effective in having some flexibility aimed at rescuing a financially distressed company from its decline towards liquidation.

In the past, companies in financial distress in South Africa have had no alternative but to launch proceedings for liquidation. Business rescue would provide some breathing space to recover from temporary liquidity complications or more permanent indebtedness if necessary by providing the company an opportunity to restructure the business operations. Thus business rescue offers an opportunity for the efficient rescue and recovery of financially distressed companies.

The introduction of modern business rescue principles is another step forward in making South Africa more competitive. The World Bank provides that "the rescue of a business preserves jobs, provides creditors with a greater return based on higher going concern values of the enterprise, potentially produces a return for owners and obtains for the country the fruits of the rehabilitated enterprise".<sup>1</sup> Chapter 6 of the Companies Act 2008 (the Act) represents an overhaul of South Africa's former regime of judicial management of financially distressed companies. Judicial management did not obtain the level of success that the legislators may have envisioned. For this very reason liquidations were-and-are preferred as the primary insolvency procedure, as they provide a quicker and easier method for creditors to receive payment. However in keeping with international trends and standards, business rescue will have to find its place in South Africa as the primary option for companies facing such situations.

<sup>1</sup> World Bank (2011) *Principles for Effective Insolvency and Creditor/ Debtor Regimes* 6.



Companies and Intellectual  
Property Commission

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This article intends to deal with the topic by comparing the appropriateness of the business rescue regime as opposed to liquidating a business entity by looking specifically at the requirements for a successful business rescue order. Further, this article will briefly focus on the desirability and advantages of the business rescue system.

## THE NEED FOR BUSINESS RESCUE

*Business rescue is intended to serve that public interest by providing a remedy directed at avoiding the deleterious consequences of liquidations in cases in which there is a reasonable prospect of salvaging the business of a company in financial distress, or of securing a better return to creditors than would probably be achieved in an immediate liquidation*<sup>2</sup>

The Act now contains the provisions regulating the new business rescue proceedings that have replaced judicial management. This procedure is intended to give effect to one of the purposes of the Act contained in section 7. This purpose 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.” By means of improved business rescue procedures, distressed companies now have the opportunity of maintaining their status as going concerns in terms of section 7(c) of the Act. Chapter 6 of the Act introduces principles relating to business rescue that bring us into line with international principles of business rescue as they exist in foreign jurisdictions. Chapter 6 of the Act provides South Africa with a new mechanism whereby companies can recover from a financially distressed situation.

A “financially distressed” situation would occur when:

- 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.<sup>3</sup>

<sup>2</sup> Koen v Wedgewood Village Golf & Country Estate (Pty) Ltd 2012 2 SA 378 par 14.

<sup>3</sup> See s 128(1)(f) of the Act.



Companies and Intellectual  
Property Commission

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The term “business rescue” is defined in section 128(1)(b) of the Act as proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for: (i) the temporary supervision of the company and of the management of its affairs, business and property; (ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and (iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equities in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it 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. The company or affected persons <sup>4</sup> can apply to the court for business rescue proceedings. The whole process is done through a business rescue practitioner. The practitioner investigates the company’s affairs and financial situation and after having done so, considers whether there is any reasonable prospect of the company being rescued.

Thus, of great significance in terms of this concept is section 131(4)(a), which provides that after considering a business rescue application, the court may make an order placing the company under supervision and commencing business rescue proceedings. The court must be satisfied that:

- The company is financially distressed;
- 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;
- It is otherwise just and equitable to do so for financial reasons and there is a reasonable prospect for rescuing the company.<sup>5</sup>

Thus, in order to qualify for business rescue, the company must be financially distressed. However, the main requirement is that there be a reasonable prospect for rescuing the business.

<sup>4</sup> In terms of s 128(1)(a) an “affected person” in relation to a company, means (i) a shareholder or creditor of the company; (ii) any registered trade union representing employees of the company and; (iii) if any of the employees of the company are not represented by a registered trade union, each of those employees or their respective representatives.

<sup>5</sup> 2012 5 SA 515 (GSJ).



Companies and Intellectual  
Property Commission

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The prerequisites of section 131(4)(a) for a rescue order are that:

- any one of sub-sections (i), (ii) or (iii) must be fulfilled (above); and
- the court must be satisfied that there is a reasonable prospect of rescuing the company concerned.

Thus, 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. It has become evident that business rescue is an alternative option for companies facing insolvency. Rather than being placed in liquidation, it provides an alternative scheme for creditors to be settled within a reasonable period and in terms of the business rescue plan.

### **ADVANTAGES OF BUSINESS RESCUE**

- The business rescue procedure is a process that assists the continued existence of financially distressed but sustainable companies. One of the advantages of a successful corporate rescue is that it prevents or limits job losses especially in a country such as South Africa where unemployment figures are unacceptably high. The court explained in *Employees of Solar Spectrum Trading 83 (Pty) Ltd v Afagri Operations Limited*,<sup>6</sup> that business rescue represents a shift from the interests of creditors to balancing a wider range of often competing interests including those of employees and shareholders.
- A liquidation aims to obtain whatever money or value remains from a failed debtor business in order to settle claims against it, business rescue legislation provides for a restructuring of the financial structure of an ailing debtor to save the business as a going concern and to facilitate the settlement of claims against the business in full.
- Business rescue is generally attractive to creditors because it aims to achieve a result that is more favourable for them than immediate liquidation.
- While business rescue proceedings are in place, the business rescue practitioner may suspend, entirely, partially, or conditionally any agreement or provision of an agreement to which the company was a party at the commencement of the proceedings, other than an employment contract.

<sup>6</sup> Unreported 8 May 2012 (GNP) (6418/2011, 18624/2011 and 66226/2011).



Companies and Intellectual  
Property Commission

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- The commencement of business rescue proceedings results in a general moratorium on all legal proceedings against the company except with the written consent of the business rescue practitioner or with the leave of the court.<sup>7</sup> This shows to be an advantage for the debtor company, as the purpose of section 133 of the Act, is to offer the company some breathing space in order to allow its affairs to be restructured in such a way as to allow it to continue operating as a successful concern.

## ROLE OF COURTS

There have been several matters that have been brought before the High Court where the courts have been called upon to interpret and apply some of the provisions in section 131(4).<sup>8</sup> When considering whether a company should be placed under business rescue there appears to be conflicting interpretations in determining whether there is a reasonable prospect for rescuing the company.

The meaning of the words “reasonable prospect” in the context of section 131(4) has been the subject of conflicting decisions. It is unfortunate that Chapter 6 does not define or clarify what is meant by the term ‘reasonable prospect of rescuing the company’. However, the meaning of a ‘reasonable prospect’ has been decided in a number of cases such as *Southern Palace Investments*<sup>9</sup>, where the court held that a ‘reasonable prospect’ for rescuing the company indicates something less than a ‘reasonable probability’ which was required for placing a company under judicial management under the old 1973 Companies Act. Thus, one main reason for the failure of judicial management under the old Act is due to the high threshold set by the legislature and thus the threshold of a ‘reasonable prospect’ under the Act is easier to satisfy.

The court is vested with a discretion to grant or refuse the relief sought. For example, in *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd and Another (Advantage Projects Managers (Pty) Ltd intervening)*,<sup>10</sup> the applicant successfully applied for an order under section 131(4)(a) of the Act to place Pinnacle Group under supervision and for business rescue proceedings to commence.

<sup>7</sup> See s 133(1) of the Act.

<sup>8</sup> *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others* 2013 4

<sup>9</sup> 2012 2 SA 423 (WCC).

<sup>10</sup> 2011 5 SA 600 (WCC) (29 February 2012).



Companies and Intellectual  
Property Commission

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The courts discretion was further seen in *Van Niekerk v Seriso 321 CC and Another*<sup>11</sup>. The Court held that there was a reasonable prospect that the business rescue practitioner would be able to raise a further bond to pay First Rand Bank the amount due in terms of the surety agreements to enable the respondent to continue operating and generating an income for the respondent or to sell the property at a market related price thereby being in a position to pay all creditors in full.

## FINANCIALLY DISTRESSED

Therefore, financially distressed companies that are genuinely able to make a noticeable and helpful difference to all stakeholders through business rescue proceedings should apply the business rescue regime. According to the definition in the Act, “financially distressed” in reference to a particular company at any particular time, means that-

- 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.<sup>12</sup>

Many court decisions have refused business rescue, stating that the company was hopelessly insolvent and thus there was no reasonable prospect of success. In the *Gormley* case,<sup>13</sup> the court held that, the provisions of the Act make it clear that the concept of business rescue only applies to companies which are financially distressed as defined in the Act. If a company is not so financially distressed the provisions of Chapter 6 of the Act will not apply. Thus, the court adopted a narrow interpretation of ‘financially distressed’ and held that a company that is already insolvent, even if only able to pay its debts over an extended period, is not financially distressed as defined in the Act.<sup>14</sup>

<sup>11</sup> (952/11, 23929/11) [2012] ZAWCHC 63 (20 March 2012).

<sup>12</sup> s 128(1)(f).

<sup>13</sup> 19075/11 (WCC) (18 April 2012) para 11.

<sup>14</sup> See s 136(1)(a) of the Companies Act 71 of 2008.



Companies and Intellectual  
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## ABUSE

There is always the risk that business rescue proceedings may be abused by a company with no prospect of financial recovery to obtain a temporary respite from creditors. However, in order to try and prevent such abuse, the Act now provides certain procedural requirements.<sup>15</sup>

In *Advanced Technologies and Engineering Company (Pty) Ltd v Aeronotique et Technologies Embarquees SAS*<sup>16</sup> making an order, the court held that “it is clear from the relevant sections contained in chapter 6 that a substantial degree of urgency is envisaged once a company has decided to adopt the resolution beginning rescue proceedings. If there is non-compliance with section 129(3) or (4) the relevant resolution lapses and is a nullity. This approach was also adopted in *Madodza (Pty) Ltd (in business rescue) v Absa Bank and Others*,<sup>17</sup> in which the court declared that the business rescue resolution had lapsed and become a nullity.

## LIQUIDATION AS OPPOSED TO A BUSINESS RESCUE ORDER

The Act provides for section 131(4)(b), which states that the court may after dismissing the business rescue application, can make any appropriate order, including an order placing the company under liquidation. In *Oakdene Square Properties (SCA)* the court held that business rescue was not appropriate in these circumstances and that liquidation of the company was the preferred remedy. The court held that in light of certain factors, there is a real possibility that liquidation will in fact be more advantages to creditors and shareholders than the proposed informal winding-up of the company through business rescue proceedings. Therefore, as one of the purposes of the Act is to facilitate the efficient rescue of financially distressed companies, a court will give preference to business rescue over liquidation but only where there is a genuine attempt to achieve the aims of the Act.

Accordingly, it is clear from judgments above that the South African courts are embracing a realistic pragmatic approach and is not open to being influenced by vague and speculative averments as to the prospects of restoring an ailing business entity to solvency. Therefore, financially distressed companies that are genuinely make a noticeable and helpful difference to all stakeholders through business rescue proceedings should apply.

<sup>15</sup> s 129(3) and (4). (Voluntary initiation (by resolution)).

<sup>16</sup> unreported, GNP case no 72522/11, 6 June 2012

<sup>17</sup> (38906/2012) [2012] ZAGPPHC 165 (15 August 2012).



Companies and Intellectual  
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The cases dealing with Chapter 6 show a willingness by the courts to engage the new business rescue procedure, although clearly the provisions of the Act are posing some challenging interpretational problems. Nevertheless, business rescue is aimed at providing an alternative to a liquidation process, to make it easier for companies in financial difficulty to be rescued and to continue as commercially viable businesses. Business rescue brings the country in line with international trends but also maximises returns for creditors, saves jobs and ultimately gives financially distressed companies a chance to trade their way out of financial difficulties.

*This CIPC Compliance Focus is issued to create awareness and education amongst industry and concerned parties.*

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