

**A LEGAL ANALYSIS OF LAWS REGULATING THE VIABILITY OF BUSINESS  
RESCUE IN SOUTH AFRICA**

By

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## **DECLARATION BY STUDENT**

I declare that the dissertation submitted by me to the University of Limpopo for the degree Master of Laws in Development and Management Law has not previously been submitted for degree purposes at this or any other university. This is my own work in design and execution and all materials contained herein have been duly acknowledged by means of complete references.

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Date

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To the most wonderful parents a son can have, Sarah Milanzi and Motshabeng Skhosana.

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## **ABSTRACT**

One of the fundamental objectives of the new Companies Act 71 of 2008 is to provide for efficient rescue of financially distressed companies. It is almost four years since the Act introduced the regime of business rescue, therefore details about its success or lack thereof must be examined so as to consider its viability in South Africa. With a very higher degree of certainty, the regime has so far shown some inherent shortcomings embodied in its application. Business rescue has had implications on corporate governance and taxation in South Africa. Against this new corporate scene, mini-dissertation analyses the most controversial aspects and the most telling implications of the business rescue regime since its inception in South African company law. Furthermore, this mini-dissertation analyses the call for further modification of the business rescue regime. Most importantly it spells out several recommendations which if considered pragmatically will constructively contribute to the viability of the business rescue regime in South Africa. It finds that the business rescue regime in South Africa is almost likely to be viable.

**KEY WORDS:** business rescue, financially distressed and affected persons.

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## CHAPTER ONE: INTRODUCTION

### 1.1 INTRODUCTION

A thriving company is an asset to the employer, the employees and the economy because its business activities will continue to have direct impact on the socio-economic welfare of all who depend on it for their livelihood and survival.<sup>1</sup> A company should continue as a going-concern so as to perform and provide the necessary socio-economic needs.

Just like any endeavor in life, a company may at a particular time find itself in a situation where, for one reason or another, is struggling or facing a possibility of failing to meet its corporate and financial obligations to its creditors. It is important that the company should be rescued from the state of being financially distressed or facing possible liquidation. This is done so that jobs will be saved and employees will continue to perform their social, civil and domestic responsibilities. The company will also continue to serve as a viable asset to the country and the economy through paying taxes, salaries and wages to employees, make payments to suppliers and distributors and so on.

In South Africa, before the introduction of the business rescue regimes, ailing and financially distressed companies were taken through the process of liquidation,<sup>2</sup> which was considered to be an extremely harsh action, usually resulting into socio-economic destabilisation to the employees, employers, the economy and the country. It is against the backdrop of ensuring that companies are rescued from any financial stress that the South African Parliament passed the Companies Act 71 of 2008 (hereinafter referred to as the Companies Act). The Act came into force on the 1<sup>st</sup> of May 2011 and contains the provisions regulating the new business rescue proceedings that replaced the judicial management under the Companies Act 61 of 1973.

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<sup>1</sup> Savitz, Andrew, The triple bottom line: How today's best-run companies are achieving economic, social and environmental success and how you can too. John Wiley & Sons, California, 2012, USA

<sup>2</sup> Bradstreet, R (2001) The new business rescue: Will creditors sink or swim? South African Law Journal, 128(2) 352-380

The business rescue system is a viable way of rescuing financially distressed companies in order to protect them from collapsing and outright liquidation.<sup>3</sup> It is common knowledge that a thriving business ensures continuity, saves jobs and protects the workers and all those who rely on the company for their livelihood including the creditors.<sup>4</sup> A business rescue system instils confidence in foreign investors as opposed to the system that will liquidate the company and create panic within and outside the country.<sup>5</sup>

Currently, South Africa is experiencing a high rate of unemployment,<sup>6</sup> therefore liquidating an ailing company will exacerbate the already critical unemployment problem because workers will lose jobs.<sup>7</sup> This will have a serious impact on the standard of living and socio-economic welfare of the people. Considering the potential hardships that will occur if a company is liquidated, it is important that the company be rescued as this will pave way for the possibility of recovering money from debtors which could be used to settle the claims against the ailing company.<sup>8</sup>

In view of the above, it is therefore pertinent to assert that business rescue seeks to restructure an ailing debtor company<sup>9</sup> in order to save the business from collapse and sometimes facilitating the settlement of claims so as to ensure continuity and sustainability of the business. Business rescue is progressive because it enables the company to continue to operate as a going-concern.<sup>10</sup> On the other hand, liquidation is

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<sup>3</sup> Uchechukwu, MS., & Tajti, T. (2015) Rethinking business rescue in Nigeria: borrowing virtues from chapter 11 of the us bankruptcy code, available at etd.ceu.hu, <http://www.etd.ceu.hu/2015/mba> accessed on 15 April 2015.

<sup>4</sup> Gray, D. (2004). Start and run a profitable consulting business. North Vancouver:International Self -Counsel Ltd.

<sup>5</sup> Kaplan, RS., & Norton, D.P. (2001). The strategy-focused organization: How balanced scorecard companies thrive in the new business environment. Massachusetts: Harvard Business School Publishing Incorporation.

<sup>6</sup> Klasen, S., & Woolard, I. (2009). Surviving unemployment without state support: unemployment and household formation in South Africa. *Journal of African economies*, 18(1), 1-51.

<sup>7</sup> Nkechi, A., & Emeh Ikechukwu, E.J. (2012). Entrepreneurship development and employment generation in Nigeria: Problems and prospects. *Universal Journal of Education and General Studies*. 1(4), 088-102.

<sup>8</sup> Lara-Jade Sher, The appropriateness of business rescue as opposed to liquidation ( unpublished LLM dissertation, University of Johannesburg) 2013

<sup>9</sup> Rajak Harry and Henning Johan Business Rescue for South Africa (199) 116 SALJ. 262

<sup>10</sup> Bieberstein, N. (2006). Service-oriented architecture compass: business value, planning, and enterprise roadmap. Retrieved from: <https://books.google.co.za/books?hl=en&lr=&id=NISyExeJ5mAC&oi=fnd&pg=pnV9&sig=jg73IyDVNIpfq2IKnXVIC0SvuB8#v=onepage&q&f=false>.

regressive in nature because it seeks to terminate the operations of the company,<sup>11</sup> share whatever is recovered and close it down. The aftermath effects of a company's liquidation on the economy, the country and the employees are usually associated with increased unemployment, hardships and loss of revenue to the government.<sup>12</sup>

Business rescue is considered as an integral part of sustainable economic growth and socio-economic development.<sup>13</sup> The process protects existing jobs as a result of restructuring, with workers continuing to be gainfully employed, reduced risk of unemployment and joblessness, and the company continuing to pay its fair share of tax towards the financial stability of the country. There is a profound connection among business rescue, sustainable viability of the company, economic growth and development, job security and socio-economic well-being of the employees.<sup>14</sup>

The business rescue provisions as contained in Chapter 6 of the Companies Act therefore highlight significant changes in the South African Corporate law.<sup>15</sup> To this end, it is the responsibility of the judiciary and all role players to ensure that the process of business rescue is utilised effectively implemented in order to fulfil the ultimate purpose for which business rescue was introduced.

## **1.2 RESEARCH PROBLEM**

### **1.2.1 STATEMENT OF THE RESEARCH PROBLEM**

In South Africa, the harsh reality of pursuing business is to experience corporate failure or liquidation. It is clear with a degree of certainty that the inherent conditions and basic principles within which companies conduct businesses have changed tremendously since the year 2008. This happened when the world experienced the occurrence of global economic recession that crippled the economies of most developed countries, let alone a developing country like South Africa.

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<sup>11</sup> Keay A.R. (2010).The duty to promote the success of the company: is it fit for purpose? Retrieved from: <http://ssrn.com/abstract=1662411> or <http://dx.doi.org/10.2139/ssrn.1662411>

<sup>12</sup> Mohan G (2000) Structural adjustment: Theory, practice and impacts. New York. Routledge

<sup>13</sup> Berke, PR, Kartez, J, & Wenger, D (1993). Recovery after disaster: achieving sustainable development, mitigation and equity. *Disasters*, 17(2), 93-109. 1993

<sup>14</sup> Savitz op cit note 1

<sup>15</sup> Savitz op cit note 1

This has created new struggles in the corporate scene. The first struggle is for businesses to remain competitive and to perform well. On the other hand, the second hurdle is for businesses to avoid insolvency.

In its effort to manage these struggles, the legislature took a decision to consider the introduction of business rescue as the main strategy to guard against corporate failures through Chapter 6 of the new Companies Act.

Although the Act presents new challenges, they are not insurmountable, given the willingness on the part of the judiciary and other related institutions to do the right thing by correctly interpreting and applying the law in order to rescue ailing companies.

Even though the provisions of business rescue in Chapter 6 of the Companies Act seem to be appreciable the regime of business rescue has shown more controversial aspects and negative implications since its inception in South Africa. These controversial aspects and implications are affecting its viability and continue to stifle its success.

### **1.2.1 BACKGROUND TO THE PROBLEM**

The historical origins of business rescue are derived from the regime of judicial management which prevailed during the introduction of the then Companies Act 46 of 1926 in South Africa<sup>16</sup>. At this stage, the notion and concept of business rescue was still a strange and unknown to other jurisdictions across the globe<sup>17</sup>.

In this context, it is quite clear that the judicial management procedure served and supported the view that financially distressed companies must be given an opportunity and assistance to be rescued from impending liquidation. The year 1936 saw the enactment of the Insolvency Act 24 of 1936<sup>18</sup>, which was welcomed by most creditors. In this regard creditors preferred the liquidation procedure as an ultimate goal to claim

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<sup>16</sup> The Companies Act 46 of 1926 is actually one of the pieces of legislations in the world to contain business recovery provisions.

<sup>17</sup> Anneli Loubser *Judicial Management as a Business Rescue Procedure in South African Corporate Law*(2004) 16 SA Merc LJ

<sup>18</sup> The Insolvency Act 24 of 1936 was purposively introduced to consolidate and amend the law relating to insolvent persons and to their estates

from financially distressed companies. Thus, the judicial management was left hanging as a white elephant.

Subsequently, the judicial management was rarely used and thus lost its significance in both practice and theory, thus achieving so little in character and usage. In 1970 representations were made to the Van Wyk de Vries Commission calling for the abolition of judicial management in its totality on the specific grounds that it had a low success rate and was being abused.<sup>19</sup>

In the year 2001, Josman J stated in the case of *Le Roux Hotel Management (Pty) Ltd & Another v E Rand (PTY) Ltd (FBC Fidelity Bank Ltd*<sup>20</sup> that the review of the cases reveals the limited scope of judicial management in this country. Where in which the Court reviewed the history of judicial management in the law and the conservative approach the courts had followed in its interpretation and application. The Court went further to hold that international developments seemed to support the need for a more progressive attitude towards business rescue, although this required new legislation.<sup>21</sup>

The ideal opportunity to review and improve judicial management presented itself. Subsequently, three law-reform projects began to take place. The first was the reform of South African insolvency law, which sought to reform more specifically the Insolvency Act 24 of 1936. In February 2000, the South African Law Commission published as part of Project 63 its Report on the Review of the Law of Insolvency in two volumes. It contained a Draft Insolvency Bill aimed at replacing the present old Insolvency Act.<sup>22</sup>

In April 2004 the Commission reported that a new Business Rescue Bill was being drafted and was expected to be ready in May 2004.<sup>23</sup> In the policy paper on its corporate law reform project published by the Department of Trade and Industry in May 2004, insolvency and corporate rescue were specifically mentioned as areas that are to be reviewed and improved in the new company law. As a result, the Business Rescue

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<sup>19</sup> Loubser op cit note 2

<sup>20</sup> *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd* 2001 (2) SA 727 (CPD)

<sup>21</sup> *Le Roux Hotel Management* supra note 6

<sup>22</sup> See Draft Insolvency and Business Recovery Bill as proposed by the South African Law Commission for February 2004

<sup>23</sup> Loubser op cit note 2

Bill was inserted into Chapter 6 of the new Companies Act 71 of 2008 which ultimately received the force of law on May 2011.<sup>24</sup>

The regime has so far shown some inherent shortcomings embodied in its application. At the fundamental degree, business rescue has had implications on corporate governance and taxation in South Africa.

### **1.3 DEFINITION OF KEY CONCEPTS**

#### **1.3.1 Business rescue**

In terms of section 128(1)(b), “business rescue means 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 equity in a manner that maximises 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”.<sup>25</sup>

#### **1.3.2 Financially distressed**

In accordance with section 128(1)(f), financially distressed in reference to a particular company at any particular time, means “that- (i) it appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months; or (ii) it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months”.<sup>26</sup>

#### **1.3.3 Affected person**

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<sup>24</sup> See Chapter 6 of the Companies Act 71 of 2008

<sup>25</sup> Section 128(1)(b) of the Companies Act 71 of 2008

<sup>26</sup> See Sec 128(1)(f) Act 71 of 2008

In terms of section 128(1)(a), 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>27</sup>

## 1.4 LITERATURE REVIEW

The Companies Act 71 of 2008 makes provision for business rescue in Chapter 6 titled business rescue and compromise with creditors. The focus and purpose of business rescue is to provide for efficient rescue of financially distressed companies.<sup>28</sup> From this, it follows that business rescue is solely concerned with ad hoc measures to oversee the recuperation of financially ailing companies.

In corporate terms, an understood effect of business rescue is that the company’s management will be placed significantly under a temporary hegemony of a business rescue practitioner,<sup>29</sup> while at the same time, all the rights of claimants against the company will be placed under the operation of a moratorium.<sup>30</sup> The concept of business rescue springs from the realisation that the continued existence of the company is more beneficial to the society and the economy than its liquidation.<sup>31</sup>

The result that business rescue intends to achieve is to offer a financially distressed company a platform that will make it possible for it to revamp and regain itself to the ultimate benefit of all affected persons, as well as to provide for a better return for the company’s creditors or shareholders than would result from the immediate liquidation of

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<sup>27</sup> See Sec 128(1)(a) Act 71 of 2008

<sup>28</sup> See Preamble of the Companies act 71 of 2008

<sup>29</sup> Rotman, JL (2008). *The finance Crisis and Rescue: What went wrong? What lessons can be learned?* Toronto: University of Toronto Press.

<sup>30</sup> Richard Bradstreet *The Leak in the Chapter 6 Lifeboat: Inadequate Regulation of Business Rescue Practitioners May Adversely Affect Lenders’ Willingness and the Growth of the Economy* (2010) 22 SA Merc LJ 195

<sup>31</sup> FHI Cassim, MF Cassim, R Cassim, R Jooste, J Shev and J Yeats, *Contemporary Company Law*, Juta , 2012 Durban at 17

the entity.<sup>32</sup> All in all, business rescue purposively provides a reasonable balance between the interests of a debtor company in financial difficulty and its creditors.<sup>33</sup>

Vriesendorp and Gramatikiv indicate that “when businesses become over leveraged or financially distressed, frequently for reasons beyond their control, e.g. an economic recession, access to finance becomes increasingly difficult; in some cases virtually impossible. These difficulties force distressed businesses to confront the possibility of liquidation”.<sup>34</sup>

The liquidation approach has been widely criticised as it hinders economic growth and economic development. According to Anneli Loubser, “a company's failure affects not only its members and creditors, but also, among others, its employees, suppliers and distributors, and, through them, the community at large”.<sup>35</sup> Cassim is of the same assertion, by indicating that “the winding-up or shut-down of a company has widespread repercussions for the incumbent management, shareholders and the employees of the company, and also for creditors, suppliers and the economy”.<sup>36</sup>

Du Preez observed that “with the onset of globalisation and markets being exposed to the effects of global recessions and economic downturns, the fundamental principles on which business operates have changed substantially”.<sup>37</sup> He further asserts that “the concept of corporate renewal and business rescue has become an integral element of the strategy of organisations”.<sup>38</sup>

In the case of *Madodza (Pty) Ltd v ABSA Bank Limited*<sup>39</sup>, Tolmay J held that “the whole purpose of a business rescue proceedings 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

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<sup>32</sup> Companies and Intellectual Property Commission Annual Report 2013/2014

<sup>33</sup> Shawn Kopel, *Guide to Business Law*, 5<sup>th</sup> ed,(2012), Oxford, Cape town,p 242

<sup>34</sup> Vriesendorp and Gramatikov,Funding corporate: The impact of the financial crisis, *International Insolvency Review*, 2010 19 (3) 209-237

<sup>35</sup> Loubser op cit note 2 at

<sup>36</sup> Cassim et al *Contemporary Company Law* op cite note 22 at 17

<sup>37</sup> Wanya Du Preez *The status of post-commencement finance for business rescue in South Africa* ( unpublished MBA thesis, University of Pretoria, 2012) 12.

<sup>38</sup> Ibid at 9

<sup>39</sup> *Madodza v ABSA Bank Limited and Others (GNP)* unreported case no 38906/2012 ( 15 August 2012)



continue operating as a successful concern”.<sup>40</sup> The court went further to hold that “it would seem that internationally the end result sought to be achieved by business rescue is to have a business continue as a going concern”.<sup>41</sup>

Rajak and Henning suggest that “the business rescue provision is widely supported as a means of saving jobs and of protecting investment”.<sup>42</sup> In support of this sentiment, Anneli Loubser states that “having a successful and effective corporate rescue regime or procedure is thus, of great importance to the economic growth and stability of this country”.<sup>43</sup>

The tenacity and importance of this view was restated at the massive point by Binns-Ward J in the case of *Koen and Another v Wedgewood Village Golf & Country Estate (Pty) Ltd and Others*<sup>44</sup>, when he held that “it is clear that the legislature has recognised that the liquidation of companies more frequently than not occasions significant collateral damage, both economically and socially, with attendant destruction of wealth and livelihoods”.<sup>45</sup> To avert against the aforementioned collateral damage, the legislature has innovatively supported a model of business rescue which allows employees of the debtor company to remain in the employment and all the suppliers of goods, services or inputs regarded as essential to continue supplying such goods, services or inputs on the same terms and conditions.<sup>46</sup>

Pursuant to this, the company’s board and directors must continue to perform and exercise their functions subject to the direction of the business rescue practitioner.<sup>47</sup> The rationale here is that the incumbent management is most familiar with the extent of the financial difficulties of the company in question.<sup>48</sup> To this end, Sharrok points out that “a director remains bound by the duty to disclose personal financial interest or

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<sup>40</sup> Madodza supra note 30.

<sup>41</sup> Madodza supra note 30.

<sup>42</sup> Rajak Harry and Henning Johan *Business Rescue for South Africa* (199) 116 SALJ. 262

<sup>43</sup> Anneli Loubser *Some Comparative Aspects of Corporate Rescue In South African Company Law* (unpublished thesis LLD University of South Africa) 2011

<sup>44</sup> *Koen and Another v Wedgewood Village Golf & Country Estate (Pty) Ltd and Others* 2012 (2) SA 378 (WCC)

<sup>45</sup> Koen case supra

<sup>46</sup> Kopel op cit note 24 at 425

<sup>47</sup> Ibid

<sup>48</sup> Cassim et al *Contemporary Company Law* op cite note 22 at 18

those of a related person as required by section 75 of the Companies Act.<sup>49</sup> Section 75 of the Companies Act is the main provision in the Companies Act that regulates the director's financial personal interests".<sup>50</sup> Du Preez accentuates that "one of the critical components of the success of the business rescue involves securing turnaround finance (post-commencement finance) to restore the company's financial health".<sup>51</sup>

The current business rescue model in South Africa makes provision for the board of a company to make a resolution that the company voluntarily begins 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.<sup>52</sup>

It is important, however, to point out that the board of a company may not adopt any resolution to place the company under business rescue if liquidation proceedings have already been initiated by or against the company.<sup>53</sup> Moreover, such a resolution will have no force or effect until it has been filed.<sup>54</sup>

The board is of course not the only party entitled to institute business rescue proceedings. Section 131(1) of Act 71 of 2008 makes it possible for affected persons to apply to court for an order to place the company under supervision and therefore commencing business rescue.<sup>55</sup>

Business rescue, as the definition indicates, is a company's self-administered process which is largely dependent upon an independent supervision which must be properly exercised within the limitations as set out in Chapter 6 of the Act, and subject to court intervention at any time on application by any of its stakeholders.<sup>56</sup>

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<sup>49</sup> Robert Sharrock, Kathleen Van Der Linde and Alatair Smith, 9th edition, Juta, Cape Town, 2012 at 283 see also Section 75 of the Companies Act

<sup>50</sup> See Section 75 of the Companies Act

<sup>51</sup> Du Preez op cit note 28 at 10

<sup>52</sup> See Sec 129(1) of Act 71 of 2008.

<sup>53</sup> See Sec 129(2)(a) of Act 71 of 2008.

<sup>54</sup> See Sec 129(2)(b) of Act 71 of 2008.

<sup>55</sup> See Sec 131(1) Act 71 of 2008

<sup>56</sup> Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd (GSJ) unreported case no 13/12406 (10 May 2013)

As stated above, the effect of business rescue is that once the company has entered into business rescue proceedings, no legal proceedings including enforcement action, against the company or in relation to any property belonging to the company or lawfully in its possession, may be commenced or proceeded with in any forum.<sup>57</sup>

The moratorium is subject to certain limited exceptions which are strict in nature and extent. These exceptions deserve a chapter of their own and will as such be discussed in depth in the next chapter. Just to mention but a few, legal proceedings may be instituted against the company already in business rescue proceedings, provided that such legal proceedings are associated with a written consent of the business rescue practitioner or with leave of the court.<sup>58</sup>

In the case of *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd*<sup>59</sup>, it was held that 'In or during business rescue proceedings or processes, it is no longer necessary for a company to get or obtain the court's approval first in order to obtain the protections offered by business rescue, including the freezing of creditors' claims. All that is now required, to get the process in motion is a directors' resolution that effectively declares that the company is, or could soon be, in a financial difficulty and that also appoints an independent person, selected by the board of directors, called "a business rescue practitioner'.<sup>60</sup>

According to Statistics South Africa in its statistical release on Statistics of Liquidations and Insolvencies delivered for January 2015, the number of companies' total liquidations for 2014 was reported to be at 1028, where 806 were voluntary liquidations and 222 were compulsory liquidations.<sup>61</sup> At the fundamental level, this shows an appreciable decline in liquidations as compared to the total number of 1939 liquidations

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<sup>57</sup> See Sec 133(1) Act 71 of 2008

<sup>58</sup> See Sec 133(2) Act 71 of 2008

<sup>59</sup> Merchant West Working Capital Solutions supra note 47

<sup>60</sup> Merchant West Working Capital Solutions supra note 47

<sup>61</sup> Statistics South Africa, Statistics on Liquidations and Insolvencies 2014 P0043 (23 March 2015)

experienced in 2010<sup>62</sup>, before the promulgation of the new Companies Act. This decline has been observed ever since then.

The impact and the importance of the provisions of Chapter 6 of the Companies Act 2008 have been hailed as a vast improvement on the previous judicial management mechanism. Broadly, the business rescue process holds a far more promise than the previous judicial management procedure which was a dismal failure.<sup>63</sup> Thus, the current business rescue provisions are some of the most important and innovatory sections of the Companies Act.<sup>64</sup>

It is noteworthy to submit that company liquidations have been on the decrease since the inception of the Companies Act in 2011. In essence, the most telling concern here is that the higher number of company liquidations are voluntary liquidations. In a purely speculative way, it would seem that voluntary liquidations are still to some extent a preferred way for financially distressed companies over business rescue.

Surprisingly, a total number of 806<sup>65</sup> companies subjected themselves to voluntary liquidations in the year 2014 while they had the option of business rescue at their disposal as provided for in Chapter 6 of the new Act. It is only proper to make a submission that this is not ideal since the business rescue regime is now turning its wheels in South Africa. In fact, the imperative submission is that companies should not shun business rescue proceedings.

As far as the interpretation of the Act is concerned, the courts have been prudently applying the relevant provisions of the Act especially in the area of business rescue.<sup>66</sup> This could be more essential in providing guidelines on how the Act, particularly the provisions on business rescue, should be applied in different cases and circumstances.

Within this context, it is clear that the South African law in its current form strives to strike a balance between the ultimate interests of all stakeholders and thus drifted away

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<sup>62</sup> Statistics South Africa, Statistics on Liquidations and Insolvencies 2014 P0043 (23 March 2015)

<sup>63</sup> FHI Cassim, MF Cassim, R Cassim, R Jooste, J Shev and J Yeats, *The Law of Business Structures*, Juta, 2012 Durban, p458

<sup>64</sup> Cassim et al *Contemporary Company Law* op cite note 22 at 17

<sup>65</sup> Statistics of liquidations and insolvencies 2015, Statistics South Africa, Statistical Release P0043

<sup>66</sup> Companies and Intellectual Property Commission Annual Report 2013/2014

from the long standing tradition of the so-called creditor-friendly approach, which was centered upon liquidation. In the same token, the courts are nevertheless not tolerating abusive business rescue applications brought merely to postpone inevitable liquidation.<sup>67</sup>

There is always a risk that business rescue proceedings may be abused by a company with no prospect of financial recovery to obtain a temporary reprieve from creditors.<sup>68</sup> However, no company may be placed under business rescue unless it is financially distressed and when there is a reasonable prospect of the company to be rescued.<sup>69</sup>

Therefore, it is up to the courts to keep the purpose of business rescue in mind<sup>70</sup>, as well as try by all necessary means available to combat against the potential abuse of the business rescue process in order to minimise the abuse to corrigible levels. Admittedly, there are safeguards against the abuse of this procedure.<sup>71</sup>

The reflections from the literature on business rescue show that business rescue offers a very useful alternative to the liquidation of companies<sup>72</sup>, and is good for economic growth and development. It allows for novel ideas which can generate other businesses from the rescued business. The effect of this is to create more jobs, hire more people and reduce unemployment.

Business rescue practitioners are part of the solution to ensure that distressed companies are rescued.<sup>73</sup> As part of the reform they should be trained to be pro-active by being able to sense and discover any sign of distress at the early stage of business before it escalates out of control.

## 1.5 PURPOSE OF THE STUDY

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<sup>67</sup> Claire Morgan, *South Africa's new business rescue law - the courts' view*. [www.ensafrica.com/news](http://www.ensafrica.com/news) accessed on 4 April 2015

<sup>68</sup> Sharrock, Van Der Linde and Smith op cite 39 at 275

<sup>69</sup> Shawn Kopel op cit note 24 at 425

<sup>70</sup> Hendrik Beukes, *Business Rescue and the Moratorium on Legal Proceedings*, De Rebus, Law Society of South Africa, June 2012, 36

<sup>71</sup> Cassim et al *Contemporary Company Law* op cite note 22 at 18

<sup>72</sup> Hendrik Beukes, *Business Rescue and the Moratorium on Legal Proceedings*, De Rebus, Law Society of South Africa, June 2012, 36

<sup>73</sup> Marius Pristorius *Tasks and Activities of the Business Rescue Practitioner: A strategy as practice approach*, Southern African Business Review, 17 2013 3.

### **1.5.1. AIMS**

- The study evaluates the inevitable challenges which have confronted the business rescue regime in the last four years.
- The study seeks to stimulate awareness about the provisions of business rescue.

### **1.5.2 OBJECTIVES**

- The key objective of this study is to examine the laws regulating business rescue in South Africa.
- It will further analyse the implications of these laws on other relevant legal fields in South Africa.

## **1.6 RESEARCH METHODOLOGY**

The research methodology in this study is qualitative. This research is library based and relies on textbooks, reports, legislations, regulations and articles. Consequently, a combination of comparative and historical methods, based on jurisprudential analysis were employed. The study refers to the development and modification of business rescue jurisprudence and corporate law. It proposes solutions, modifications and amendments to the existing laws and policies, based on empirical and historical facts.

## **1.7 THE SIGNIFICANCE OF THE STUDY**

It is hoped that the study will contribute to the debate on the viability of laws regulating the current model of business rescue in South Africa. The study will constructively assist the Department of Trade and Industry in addressing the challenges already confronting financially distressed companies undertaking business rescue proceedings. Essentially, the study will pragmatically benefit business rescue practitioners, legal practitioners, boards of directors of companies and the Companies and Intellectual Property Commission as well as countries that are yet to draw lessons from the South African model of business rescue.

## **1.8 CONCLUSION**

Business rescue as opposed to outright liquidation is a welcomed phenomenon in South Africa as it has assisted some ailing companies to continue in business. It is therefore imperative, to assert that the laws regulating business rescue in South Africa have been developed in such a way that they give the business rescue practitioner a major role to play in ensuring the proper implementation of every aspect of the company being rescued, including the implementation of the approved and adopted business rescue plan. For this reason, it is important that the original management of the company must serve and support every reasonable initiative taken by the business rescue practitioner.

## **CHAPTER TWO: BUSINESS RESCUE IN SOUTH AFRICA**

### **2.1 INTRODUCTION TO BUSINESS RESCUE**

In the South African context, if the board of a company has reasonable grounds to believe that the company is financially distressed and there appears to be a reasonable prospect of rescuing the company, the board in question may resolve that the company voluntarily begin business rescue proceedings and place the company under supervision<sup>74</sup>. The company will not be considered as insolvent at this stage, but will be viewed as merely experiencing problems of cash flow.<sup>75</sup>

Fundamentally, the business rescue process may commence either with a resolution passed by its directors or as a result of an application to a court of law brought by an “affected person”, namely, a shareholder, creditor or employee of the company or the employees’ trade union<sup>76</sup>.

In the case of an application to a court procedure, both the company and its directors are strangely excluded from this provision in their capacity as such. This position induces the rise to a question as to; what happens in the event when one or more directors are shareholders of the company? Will such a director or directors be entitled to exercise their right to lodge an application to court to place the company under business rescue by virtue of them being shareholders and thus affected persons in terms of the Act? Surprisingly, this position has not been authoritatively considered in South African law.

Notwithstanding, It is common knowledge that such a director or directors must be entitled to move the application to court though not in their capacity as directors but as shareholders. At the most crucial point, this must be viewed with a greater interrogation

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<sup>74</sup> See Sec 129(1)

<sup>75</sup> Cassim et al Contemporary Company Law op cite note 22 at 17

<sup>76</sup> Morgan op cit note 58



by the court in question, fundamentally to prevent and manage the likelihood of an abuse of process.

It must be borne in mind that the purpose of business rescue is outlined in section 128(1)(b) of the Companies Act<sup>77</sup>, in the form of objectives which must be met to obtain an order of court to commence business rescue. Therefore, the threshold standard for deciding on whether an order is appropriate or not is based on the reasonable prospect or reasonable possibility of achieving rescue through statutory objectives<sup>78</sup>. Moreover, it is noteworthy to conceive that it is almost preferable to rescue a company than to let it drift into extinction<sup>79</sup>.

## **2.2 THE REQUIREMENTS TO COMMENCE BUSINESS RESCUE**

The requirements to commence business rescue proceedings and the standard of evidence that must be met by applicants have been clearly laid down.<sup>80</sup> It is always important to turn quick and extrapolate on these requirements and their inherent standard of evidence which must be shown. It is acknowledgeable that our courts have attempted to interpret these requirements and applied them for the past years since the business rescue procedure was promulgated.

### **2.2.1 Resolution to begin business rescue**

The board of directors of a company may take a resolution, by virtue of the statutory provision apparent in section 129(1) of the Companies Act<sup>81</sup>, to voluntarily commence business rescue proceedings in respect of the company if they have reasonable

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<sup>77</sup> Sec 128(1)(b) provides that “business rescue” means 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 equity in a manner that maximises 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;

<sup>78</sup> Absa Ltd v Newcity Group (Pty) Ltd 2013 All SA 146 (GSJ)

<sup>79</sup> Absa Ltd supra note 70

<sup>80</sup> Morgan op cit note 58

<sup>81</sup> Sec 129(1) is of course subject to section 129(2)(a) which provides that the resolution contemplated in subsection (1)-(a) may not be adopted if liquidation proceedings have been initiated by or against the company.

grounds for believing that the company is financially distressed and that there seems to be a reasonable prospect of rescuing it<sup>82</sup>.

This stipulation clearly suggests two preconditions to commence business rescue. It will be seen that, the board of directors must have a reasonable belief that these grounds exist and are evident at the time when the resolution is taken. Thus, it must show justifiable good reasons for this belief to add on the first precondition.

The requirement that the board must have reasonable grounds for believing, and not necessarily that such reasonable grounds must exist, clearly suggests that the test is objective (that is to say, whether a reasonable person, with the acquaintance, comprehension, proficiency and knowledge of the directors, would believe that these circumstances exist).<sup>83</sup> This might seem to be a simple task to reckon with, however in practice, it has been a great deal of difficulty for both practitioners and the courts on what this requirement precisely entails. Hence, most cases of business rescue have been centered upon the interpretation of this requirement.

### **2.2.1.1 Financially distressed**

One of the most crucial requirements that must be satisfied for a company to undertake business rescue is that the company in question must be financially distressed. Thus, according to the Companies 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 become 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>84</sup>

From this, it is clear that Chapter 6 defines financial distress in terms of two legs, firstly, the company should not be able to pay its debts for a six month period and secondly, the company has the potential of becoming insolvent within the immediate six month

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<sup>82</sup> Loubser op cit note 34

<sup>83</sup> Loubser op cit note 34

<sup>84</sup> Section 128(1)(f) of the Companies act, see also Loubser op cit note 34 at 56 and Du Preez op cit note 28 at 12

period.<sup>85</sup> A company may find itself in distressed circumstances due to a conspiracy of circumstances but which can be cured if adequate time and careful management are tendered in.<sup>86</sup>

### **2.2.1.2 Reasonable prospect of rescuing the company**

There is an assertion that the afore-mentioned requirement, just to recount, of a “reasonable prospect” for rescuing a company must be read in conjunction with the definition of “business rescue” as provided for in section 128(1)(b)<sup>87</sup>. This assertion was openly and juridically shared by Eloff A J. Even here, this assertion shall be given intensive consideration so as to induce the sense of a clear understanding of what this requirement entails in totality.

A deep reflection of the difficulty caused by this requirement was encountered almost twenty nine days after the promulgation of the Companies Act. On or about the 30<sup>th</sup> of May 2011, exactly the same month the Companies Act came into force, the first reported judgment on business rescue was handed down by Judge Makgoba in the case of *Swart v Beagles Run Investments 25 (Pty) Ltd and Others*<sup>88</sup>. In the above case, the applicant brought an urgent application seeking an order that the respondent be placed under supervision in terms of the provisions of section 131(4)(a) of the Companies Act and to commence business rescue proceedings. Subsequent to the filing of the application, the creditors intervened and were opposing the application for business rescue and also sought an order that a winding-up be granted<sup>89</sup>.

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<sup>85</sup> Du Preez op cit note 28

<sup>86</sup> Matthew Lester and Adrienne Murray, An introduction to business rescue, available at <http://www.bdo.co.za> accessed on 30 April 2015

<sup>87</sup> Section 128(1)(b) provides that “business rescue” means 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 equity in a manner that maximises 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

<sup>88</sup> *Swart v Beagles Run Investments 25 (Pty) Ltd and Others* 2011 (5) SA 422 (GNP)

<sup>89</sup> Swart supra note 80

In their application, they argued that the business rescue application by the applicant was the culmination of attempts by the company to avoid the payment of its debts. Makgoba J agreed with the intervening creditors and held that where an application for business rescue entails the weighing up of the interests of creditors and the company, the interests of creditors should carry the day<sup>90</sup>.

Thus, he held that the requirement of a “reasonable prospect” for rescuing a company must mean a “reasonable probability” of rescue. It is clear that here he followed the law relating to the judicial management of companies<sup>91</sup> which was abolished a month ago, when the new Companies Act was promulgated. It is submitted here that Makgoba J’s judgment was based upon inadequate knowledge of the purpose for business rescue provisions in the new Companies Act.

At the fundamental level, the case that has become the *locus classicus* of the judicial interpretation of the requirements for business rescue applications did not follow Makgoba J.<sup>92</sup> It was handed down six months after that initial judgment by Eloff AJ in *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd*.<sup>93</sup>

In this case, Eloff AJ held that the requirement of a “reasonable prospect” of recovery must mean something less than that the recovery should be a “reasonable probability”.<sup>94</sup> The judge remarked that the business rescue provisions heralded a new era and that the old mind-set of the creditor being almost entitled to a winding-up order as of a right was inappropriate, business rescue was to be preferred to liquidation.<sup>95</sup> However, even though he held that the substantive test has a lower threshold than for judicial management, it still lies within the court’s discretion whether or not to grant an order for business rescue<sup>96</sup>.

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<sup>90</sup> Morgan op cit note 58

<sup>91</sup> Morgan op cit note 58

<sup>92</sup> Morgan op cit note 58

<sup>93</sup> *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pt) Ltd* 2012 (2) SA 423 (WCC)

<sup>94</sup> *Southern Palace Investments* supra note 85

<sup>95</sup> *Southern Palace Investments* supra note 85

<sup>96</sup> *Southern Palace Investments* supra note 85

Thus, the judge held that allegations in this regard must contain some “concrete and objectively ascertainable details going beyond mere speculation” of the following factors: the likely costs of rendering the company capable of resuming its business, the likely availability of the necessary cash resources and any other necessary resource, and why the proposed plan will have a reasonable prospect of success<sup>97</sup>.

Two months later Judge Binns-Ward in *W G Koen v Wedgewood Village Golf*<sup>98</sup> followed by adopting the requirements laid down by Eloff AJ for successful business rescue applications, holding that “whatever the object of the proposed business rescue, whether recovery or a better return for creditors or shareholders than would result from immediate liquidation in order to succeed in the application, the applicant must be able to place before the court a cogent evidential foundation to support the existence of a reasonable prospect that the desired object can be achieved<sup>99</sup>”.

The approach of Eloff AJ and Binns-Ward J which were decisions of the Cape High Court have been followed in the South Gauteng High Court, for the first time in February 2012 by Acting Judge Coetzee in *AG Petzetakis International Holdings Limited v Petzetakis Afrika (Pty) Ltd*.<sup>100</sup>

In this case, it was held that “the absence of a final plan at the Court application phase will not necessarily be fatal to the application<sup>101</sup>.” It was submitted that this approach must be correct, it being neither desirable nor correct that the finer details of the business rescue had to be worked out before the company could be placed under supervision.

In February 2012, Judge Classen in *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd*<sup>102</sup> also followed the approach of Eloff AJ and Binns-

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<sup>97</sup> Southern Palace Investments supra note 85

<sup>98</sup> *Koen v Wedgewood Village Golf & Country Estate (Pty) Ltd And Others* 2012 (2) SA 378 (WCC)

<sup>99</sup> *Koen* supra note 90

<sup>100</sup> *A G Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd and Others* 2012 (5) SA 515 (GSJ)

<sup>101</sup> *A G Petzetakis* supra note 92

<sup>102</sup> *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* 2013 (3) All SA 303 (SCA)

Ward J<sup>103</sup>. He described the lower threshold as follows: “I would add that if the facts indicate a reasonable possibility of the company being rescued, a court may exercise its discretion in favour of granting” a business rescue order<sup>104</sup>.

Based on the above facts, the judge made an order of liquidation rather than a business rescue for a number of reasons. Many of these reasons appeal to what has been argued in business rescue applications as to why business rescue should be preferred over liquidation. The judge found otherwise, for example, he stated that he failed to understand why a liquidator would be less successful than a business rescue practitioner in realising a proper market value for the company’s property; liquidations, he said, are not *per se* negative<sup>105</sup>.

Since the company in question was embroiled in so much litigations, the judge was of the view that the practitioner would not be able to define the outcome in advance in precise terms such that creditors could make a properly informed decision before voting on the plan, whereas liquidation had the advantage of bringing litigation to finality<sup>106</sup>.

It is submitted here that these judgments, have constructively contributed to the requirements for the commencement of business rescue. Hence, they have been followed extensively in both reported and unreported judgments nationwide.

## **2.2.2 The court order to begin business rescue proceedings**

Here the court is empowered in terms of section 131(4) of the Companies Act which provides that, after considering an application brought by an affected person,<sup>107</sup> the court may make an order placing the company under supervision and commencing business rescue proceedings, if the court is satisfied that, firstly the company is financially distressed, secondly, the company has failed to pay over any amount in terms of an obligation under or in terms of a public regulation, or contract, with respect to employment related matters or thirdly, it is otherwise just and equitable to do so for

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<sup>103</sup> Oakdene supra note 94

<sup>104</sup> Oakdene supra note 94

<sup>105</sup> Oakdene supra note 94

<sup>106</sup> Oakdene supra note 94

<sup>107</sup> The affected person makes the application in terms of section 131(1)of the Companies Act

financial reasons, and lastly, there is a reasonable prospect for rescuing the company.<sup>108</sup>

Thus, It may be stated that, compared to the requirements for a board resolution, the test is stricter in this instance in that 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 there is a reasonable prospect of rescuing the company.<sup>109</sup>

### **2.3 THE BUSINESS RESCUE PLAN**

The legislature has been prescriptive as to what a business rescue plan must contain. In essence, Chapter 6 has merely created a framework within which it can be developed.<sup>110</sup> As a starting point, in the case of a business rescue plan, it is important to note that should be informed and guided by the provisions of section 150 of the Act in totality.

As a starting point, a business rescue practitioner, after consulting the creditors, other affected persons, and the management of the company, must prepare a business rescue plan for consideration and possible adoption at a meeting held in terms of section 151.<sup>111</sup>

Following the above process, there is no doubt that this provision is one of the major innovations of the new business rescue dispensation, precisely because it gives foundational aspirations of how the rescue of the company will be achieved.

According to the Act, the business rescue plan must as a core matter of fact be divided into three parts. The first part must deal with the background of the company, the second must contain proposals to be made whereas the third must set out the

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<sup>108</sup> Section 131(4) of the Companies Act

<sup>109</sup> Loubser op cit 34

<sup>110</sup> Gormley v West City Precinct Properties (Pty) Ltd (WCC) unreported case no 19075/11 (18 April 2012)

<sup>111</sup> See Section 150 (1) of the Companies Act. The meeting called under section 151 is solely for the purpose of considering the plan

assumptions and conditions.<sup>112</sup> From this, it follows that the business rescue plan must contain all the information reasonably required to facilitate affected persons in deciding whether or not to accept or reject the plan.<sup>113</sup>

### **2.3.1 The first part (Part A-Background)<sup>114</sup>**

This particular part serves to unpack the background of the company and it must contain at least 6 items as described in the Act. Firstly, it must provide a complete list of all the material assets of the company, as well as an indication on which assets were held as security by creditors when the business rescue proceedings began.<sup>115</sup>

Secondly, it must include a complete list of the creditors of the company when the business rescue proceedings began, as well as an indication about which creditors would qualify as secured, statutory preferent and concurrent in terms of the laws of insolvency, and an indication of which of the creditors have proved their claims.<sup>116</sup>

The reference to the laws of insolvency raises some doubts about the exact position of employees who are owed money relating to their employment before the start of business rescue proceedings.<sup>117</sup> It must be noted that in terms of the Insolvency Act, claims relating to employment prior to insolvency only enjoy preference for a specific period and up to a specific amount.<sup>118</sup>

Thirdly, it must include “a probable dividend that would be received by creditors, in their specific classes, if the company were to be placed in liquidation”.<sup>119</sup> In this particular item, it is crucial that the business rescue practitioner avoid claims from creditors that are misleading. In fact, a business rescue practitioner should employ a careful in his or

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<sup>112</sup> See Section 150(2) of the Companies Act, it gives a detailed list and averments which must be made in the business rescue plan. This study will consider this list and averments at the preceding stage in this chapter.

<sup>113</sup> Section 150(2)

<sup>114</sup> Part A of the business rescue is prescribed in the provisions of Section 150(2)(a)

<sup>115</sup> Section 150(2)(a)(i) of the Companies Act

<sup>116</sup> Section 150(2)(a)(ii) of the Companies Act

<sup>117</sup> Loubser op cit 34

<sup>118</sup> Section 98A(1) of the Insolvency Act 24 of 1936

<sup>119</sup> Section 150(2)(a)(iii) of the Companies Act



her estimates since there may be a number of factors that cannot be predicted with any degree of accuracy and certainty that may influence these figures.<sup>120</sup>

Furthermore, a business plan must have a complete list of the holders of the company's issued securities.<sup>121</sup> For this reason, one is left with the idea that according to this provision, the fact that the list must be complete implies that no name of a holder of issued securities of the company should be missed.

However, there is a belief that it is difficult to find any real purpose of requiring a list with each person's name, especially if their rights will not be affected by the plan, as would usually be the case with shareholders.<sup>122</sup> In addition, it must have a copy of the written agreement concerning the practitioner's remuneration.<sup>123</sup>

Finally, it must contain a statement whether the business rescue plan includes a proposal made informally by a creditor of the company.<sup>124</sup> This refers to proposals that must be made before or while the plan is being drafted, since a creditor may also propose an amended or alternative plan if the original one is rejected by the creditors.<sup>125</sup>

### **2.3.2. The Second Part (Part B Proposals)<sup>126</sup>**

Part B deals with the proposals which the company seeks to put during the process of business rescue. This part must deal with at least 7 items which are all essential in the proposal. Firstly, is the nature and duration of any moratorium for which the business rescue plan makes provision.<sup>127</sup> Secondly, the extent to which the company is to be

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<sup>120</sup> Loubser op cit 34

<sup>121</sup> Section 150(2)(a)(iv) of the Companies Act

<sup>122</sup> Loubser op cit 34, here Loubser strongly argued against this provision to the extent that she stated that the provision was tainted with ambiguity in that it did not provide a comprehensive understanding of who should be included in this list since the word "securities" sometimes to denote only shareholders and not all holders of securities, which would include, for example, the holders of derivative instruments, bonds and debentures.

<sup>123</sup> Section 150(2)(a)(v) of the Companies Act

<sup>124</sup> Section 150(2)(a)(vi) of the Companies Act

<sup>125</sup> Loubser op cit 34

<sup>126</sup> Part B of the business rescue plan is prescribed in Section 150(2)(c) of the Companies Act

<sup>127</sup> Section 150(2)(b)(i) of the Companies Act

released from the payment of its debts, and the extent to which any debt is proposed to be converted to equity in the company, or another company.<sup>128</sup>

The third item is that, it must contain the ongoing role of the company, and the treatment of any existing agreements.<sup>129</sup> In addition, the property of the company that is to be available to pay creditors' claims in terms of the business rescue plan.<sup>130</sup> Furthermore, it must provide the order of preference in which the proceeds of property will be applied to pay creditors if the business rescue plan is adopted.<sup>131</sup>

Thus, it must state the benefits of adopting the business rescue plan as opposed to the benefits that would be received by creditors if the company were to be placed in liquidation.<sup>132</sup> Finally, it must provide the effect that the business rescue plan will have on the holders of each class of the company's issued securities.<sup>133</sup>

### **2.3.3 The Third Part (Part C-Assumptions and conditions)<sup>134</sup>**

This serves as the last part of the business rescue plan and it must contain at least 4 items as described in the Act. Firstly, it must contain a statement of the conditions that must be satisfied, if any, for the business rescue plan to come into operation and be fully implemented.<sup>135</sup> Secondly, the effect that the business rescue plan contemplates on the number of employees, and their terms and conditions of employment.<sup>136</sup> Thirdly, the circumstances in which the business rescue plan will end.<sup>137</sup> Lastly, it must provide a projected balance sheet for the company and statement of income and expenses for the ensuing three years, prepared on the assumption that the proposed business plan is adopted.<sup>138</sup>

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<sup>128</sup> Section 150(2)(b)(ii) of the Companies Act

<sup>129</sup> Section 150(2)(b)(iii) of the Companies Act

<sup>130</sup> Section 150(2)(b)(iv) of the Companies Act

<sup>131</sup> Section 150(2)(b)(v) of the Companies Act

<sup>132</sup> Section 150(2)(b)(vi) of the Companies Act

<sup>133</sup> Section 150(2)(b)(vii) of the Companies Act

<sup>134</sup> Part C of the business rescue is prescribed in the provisions of Section 150(2)(c)

<sup>135</sup> Section 150(2)(c)(i) of the Companies Act

<sup>136</sup> Section 150(2)(c)(ii) of the Companies Act

<sup>137</sup> Section 150(2)(c)(iii) of the Companies Act

<sup>138</sup> Section 150(2)(c)(iv) of the Companies Act

At the most appropriate stance in the law, a proposed business rescue plan must conclude with a certificate by the practitioner stating that any actual information provided appears to be accurate, complete, and up to date<sup>139</sup> and projections provided are estimates made in good faith on the basis of factual information and assumptions as set out in the statement.<sup>140</sup>

As a matter of fact the company has a peremptory statutory obligation to publish the business rescue plan within 25 business days after the date on which the practitioner was appointed<sup>141</sup>, or such longer time as may be allowed by the court, on application by the company<sup>142</sup> or the holders of a majority of the creditors' voting interests.<sup>143</sup>

All in all, a logical assertion to be posited here is that a business rescue plan must in totality provide a broad strategic framework to guide key choices and actions which are directed at restructuring the company in question. Therefore, at the most appropriate sense, its success will depend largely on all relevant stakeholders taking responsibility for the rescue plan.

However, it is very important that the business rescue plan should not simply be a wish list nor a shopping list of items. There is simply no intelligent purpose in preparing a plan that comprises any random number of items, without any real thought having been given to which items are, in fact, affordable and which ones are reasonably likely to be implemented during the course of business rescue.

It is submitted here that the framework of Chapter 6 is to develop a more comprehensive plan to rescue the company. Therefore, the business rescue practitioner should within the given framework build and provide a comprehensive regulation which will oversee the success of the business rescue process. This on its own serves as the modern practice and is of importance for the efficient rescue of the company.

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<sup>139</sup> Section 150(4)(a) of the Companies Act

<sup>140</sup> Section 150(4)(b) of the Companies Act

<sup>141</sup> Section 150(5) of the Companies Act

<sup>142</sup> Section 150(5)(a) of the Companies Act

<sup>143</sup> Section 150(5)(b) of the Companies Act

In addition, the conceptual framework of the business rescue plan must support the objectives of business rescue as set out in section 128(1)(b).<sup>144</sup> In factual terms, this is deeply rooted to address the main causes of the financial problems of the company and will enhance, if not empower the company to fulfill its business rescue mandate.

Most significantly, a business rescue plan serves imperatively as a recovery guideline which if implemented successfully will serve the purpose of efficient rescue in respect of the financially ailing company. As a point of suggestion, the business rescue plan must pragmatically encompass the achievement of effective use of available resources, business rescue strategy certainty, meaningful development of weaknesses and a meaningful investment on the strengths of the company. Thus, without a precise rescue and recovery strategy, the purpose of business rescue may not be effectively implemented.

A successful implementation of a business rescue plan, is one which would have eradicated financial distress and addressed the needs of the company by enhancing its financial growth and restoring it to its competitiveness in the market. In the same token, a successful business rescue must provide long-term solutions which will enforce financial discipline and generate the necessary cash flows of the company.

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<sup>144</sup> Section 128(1)(b) states it clearly that “business rescue” means proceedings to facilitate the rehabilitation of a company that is financially distressed.

## CHAPTER THREE:

### 3. THE EFFECT OF BUSINESS RESCUE PROCEEDINGS

#### 3.1 INTRODUCTION

The onset of business rescue proceedings has the effect of placing a general moratorium on all legal proceedings against the company in question. As far as business rescue is concerned, its purpose is to provide an essential breathing space while a business rescue plan is being implemented.<sup>145</sup> From this, it follows that the most appropriate way of this relief from distress can only be attained through the placement of a moratorium on all legal proceedings.

To begin this chapter, it is important to reiterate the sentiments shared by Ellof AJ when he pointed out that *“the business rescue application must address the cause of the demise or failure of the company’s business, and offer a remedy therefor that has a reasonable prospect of being sustainable”*<sup>146</sup>. In order for the said remedy to be fulfilled, it is necessary that whatever legal proceedings which may be pursued against the company be kept in abeyance for a particular time as determined by the court and all relevant stakeholders.

Under these conditions, business rescue practitioners have at their disposal three primary tools not available to the directors of the ailing company. Firstly, the company under supervision enjoys a moratorium on claims by creditors. Secondly, the practitioner may suspend contractual obligations that the company was a party to at the commencement of the business rescue which become due during its supervision. Thirdly, the business rescue is meant to culminate in the adoption of a plan as voted on by creditors, employees, trade unions, and, in certain instances, shareholders, which plan should provide flexible solutions for the company. For example, creditors’ claims may be repaid over a much longer period of time than would have been allowed

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<sup>145</sup> Lidino Trading 580 CC v Cross Point Trading (Pty) Ltd In re Mabe v Cross Point Trading 213 (Pty) Ltd (FS) unreported case no 2130/2012 (23 August 2012)

<sup>146</sup> Southern Palace Investments supra note 85

contractually or creditors may vote to accept a cramming down in respect of some or all of their claims<sup>147</sup>.

The effect of business rescue can be summed up in four categories. Firstly, there is the general moratorium, which is almost the most important effect induced by the commencement of business rescue. Secondly, there is the effect of business rescue on the protection of property interests as regulated by the provisions of section 135 of the Companies Act. Thirdly, is the effect of business rescue on employees and contracts, which effect is given force by the provisions of section 136. Lastly, is the effect of business rescue on shareholders and creditors. However, it must be noted that in as much as business rescue has an effect on certain people, the people so affected particularly the employees also have certain rights as guaranteed by the provisions of section 144 of the Companies Act. For example, the employees of a company, whether represented by a trade union or not may exercise any rights as set in the provisions for business rescue either directly, or by proxy through an employee organisation or representative.<sup>148</sup>

In the interest of clarity and convenience it is important to take a deep reflection and discussion on the aforementioned effects of business rescue in their separate form and thus followed by the rights of the people to whom these effects have an impact on.

### **3.2 THE MORATORIUM**

The moratorium offered by the activation of business rescue proceedings is statutorily regulated by section 133 of the Companies Act. In terms of which a provision is made as follows, during business rescue proceedings, no legal proceeding, including enforcement action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or proceeded with in any forum<sup>149</sup>.

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<sup>147</sup> Morgan op cit note 58

<sup>148</sup> See section 144 Companies Act

<sup>149</sup> See section 133(1)(a) Companies Act

Pertinent to mention is that, the primary motive of this provision is based on a well-founded knowledge that the company needs a breathing space to develop a rescue plan without the constant stress from creditors.<sup>150</sup> To put it differently, every corporate rescue system needs a circuit breaker that provides a breathing space whilst a consideration is given to the prospect of saving the company.<sup>151</sup>

At the most appropriate acceptance, this serves more advantages for the distressed company, since purposively section 133 bequeaths the company with an opportunity to restructure itself in a way as to allow it to perpetually put up with its operations as a successful concern<sup>152</sup>. In the case of *Investec Bank Ltd v Bruyns*, it was held that the moratorium granted by section 133(1) was a general provision that affords the company protection against legal action on claims in general<sup>153</sup>. The court went further to express the view that the statutory moratorium in favour of a company that is undergoing business rescue proceedings is a defence in *personam*<sup>154</sup>. In other words, this would be a personal privilege or benefit in favour of the company<sup>155</sup>.

While there are a number of jurisdictions where the moratorium under a business rescue model does not affect the rights of secured creditors, more and more jurisdictions have realised the need for secured creditors to be included under a moratorium. The reason for this is that if the secured creditors are allowed to freely exercise their rights in terms of the security they hold, this may frustrate the objectives of a business rescue proceeding.<sup>156</sup>

### 3.3 EMPLOYEES AND CONTRACTS

The interest of employees is prominently featured as an object of business rescue proceedings. The rights of employees are secured by business rescue proceedings.

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<sup>150</sup> Lara-Jade Sher, *The appropriateness of business rescue as opposed to liquidation* (unpublished LLM dissertation, University of Johannesburg, 2013)

<sup>151</sup> C Anderson *Viewing the proposed South African business rescue provisions from an Australian perspective*, PER 2008(1) 11

<sup>152</sup> section 133 of the Companies Act

<sup>153</sup> *Investec Bank Ltd v Bruyns* 2012 (5) SA 430 (WCC)

<sup>154</sup> *Investec Bank* supra note 144

<sup>155</sup> *Investec Bank* supra note 144

<sup>156</sup> D,A Burdette, *Some initial thoughts on the development of a modern and effective business rescue model for South Africa* (part 2) 2004 16 SA Merc LJ 409

Payments due to employees are given super-preference rights in section 135(1) and 135(3)(a)<sup>157</sup>. In South Africa, the approach bestows employees with an elevated preference by way of employees' rights as enshrined in the Act which relates to employees being meaningfully engaged on the construction of the plan and to propose an alternative plan if so desirably needed.<sup>158</sup>

In terms of section 136(1)(a) “*despite any provision of an agreement to the contrary during a company’s business rescue proceedings, employees of the company immediately before the beginning of those proceedings continue to be so employed on the same terms and conditions, except to the extent that changes occur in the ordinary course of attrition or the employees and the company, in accordance with applicable labour laws, agree different terms and conditions*”.<sup>159</sup>

In addition, this measure requires that any retrenchment of any employees as informed by the business rescue plan should conform to the provisions of the Labour Relations Act 66 of 1995, particularly section 189<sup>160</sup> and 189A<sup>161</sup> of the Labour Relations Act, and other applicable employment related legislation.<sup>162</sup>

### **3.4. BUSINESS RESCUE AND TAX LAW**

As it has been shown earlier on that business rescue proceedings have an effect upon creditors, the same effect on its own also has an impact on taxation claims, in that it borders on the arena of taxation. It borders on taxation in the sense that the South African Revenue Services<sup>163</sup> is always regarded as a creditor. This in its entirety brings about tax implications during business rescue proceedings or rather the impact of business rescue on tax claims. It is noteworthy to state that the tax implications of business rescue proceedings have recently been the subject of interaction and debate

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<sup>157</sup> Lidino supra note 85 par 19

<sup>158</sup> Anderson op cit note 142

<sup>159</sup> Section 136(1)(a) of the Companies Act

<sup>160</sup> Section 189 of the Labour Relations Act 66 of 1995 deals with procedures relating to dismissals based on operational requirements

<sup>161</sup> Section 189A of the Labour Relations Act 66 of 1995 deals with dismissals based on operational requirements by employers with more than 50 employees

<sup>162</sup> Section 136(2) of the Companies Act

<sup>163</sup> Hereinafter referred to as SARS



among business rescue practitioners and SARS' representatives.<sup>164</sup> In academia, this subject has received limited consideration, due to the fact that the Companies Act is very silent on the issue.

It must be stated that business rescue has an impact on SARS' claims for tax liabilities owed to it by financially distressed companies undertaking business rescue proceedings, in that the activation of business rescue proceedings places a moratorium on all debts owed by the company engaged in business rescue. The unfortunate part of this scenario is that the legislative provisions of business rescue as contained in the Act are completely silent in addressing tax liabilities of a financially distressed company.

This situation has caused problems in respect of the status of SARS during business rescue proceedings, and as a result two schools of thoughts have emerged. The first school of thought is based on the assertion that, the taxes that arise from belated submissions of outstanding tax returns must be treated as post-commencement financing in terms of section 135 of the Act, and thus SARS enjoys the super preference in terms of section 135(3) of the Act.<sup>165</sup> The second school of thought holds that, such claims should constitute and be treated as pre-commencement claims, and thus do not enjoy any preference over other unsecured creditors.<sup>166</sup>

It is submitted here that the provisions of section 133(1)(f) of the Companies Act which provide for exceptions against the moratorium should be used by SARS to enforce its mandate to collect taxes. The section provides for an enforcement action against a company in business rescue proceedings if the creditor is a regulatory authority performing the execution of its duties.<sup>167</sup> This view stems from the fact that indeed SARS is a regulator of revenues and as such has a mandatory authority to collect taxes due, therefor qualifies within the exceptions stated in section 133(1)(f). This should be a preferred way of enforcing tax liabilities owed to SARS by companies in business rescue proceedings.

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<sup>164</sup> Milton Seligson, The impact of business rescue on tax claims, vol 5, issue 3, 2014, business tax and company law quarterly at 4

<sup>165</sup> Ibid

<sup>166</sup> Ibid

<sup>167</sup> See 133(1)(f) of the Companies Act

However, this situation was handled unsatisfactorily in the case of *Commissioner for South African Revenue Services v Beginsel NO and Others*.<sup>168</sup> In this case, the company which undertook business rescue proceedings owed SARS R11 194 677,39 which arose from outstanding Value Added Tax, Employees Tax, Skills Development Levy, Unemployment Insurance contributions, Penalties and Interests.<sup>169</sup> In this case, SARS argued that, the outstanding tax returns must be treated as post-commencement financing in terms of section 135 of the Act, and thus SARS enjoyed the super preference in terms of section 135(3) of the Act.<sup>170</sup>

The issue before the court was whether or not SARS was to be treated as a preferred creditor in business rescue proceedings.<sup>171</sup> The court held that, “*no statutory preferences are created in chapter 6 of the Act such as are created in the Insolvency Act*”.<sup>172</sup> In addition, the court made a notable pronouncement that, “*if it were the intention of the legislature to confer a preference on SARS in business rescue proceedings, it would have made such intention clear*”.<sup>173</sup> It went further to note that “*no trace of such an intention on the part of the legislature is found in the Act*”.<sup>174</sup>

The court went further to state that, “*the language of the provisions of the Act, read in context, and having regard to the purpose of business rescue proceedings, justifies only one conclusion, namely that SARS is not, by virtue of its preferent status conferred by section 99 of the Insolvency Act, a preferent creditor for the purposes of business rescue proceedings under the Act*”.<sup>175</sup>

Ultimately this case has indeed laid down the foundations to the proposition that SARS is not a preferent creditor in respect of a company undertaking business rescue and

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<sup>168</sup> Commissioner for South African Revenue Service v Beginsel NO and Others 2013(1) SA 307 (C) para 24-25

<sup>169</sup> Beginsel supra note 158 para 8.

<sup>170</sup> Beginsel supra

<sup>171</sup> Beginsel supra note 158 para 21.

<sup>172</sup> Beginsel supra note 158 para 24.

<sup>173</sup> Beginsel supra note 158 para 24.

<sup>174</sup> Beginsel supra note 158 para 24.

<sup>175</sup> Beginsel supra note 158 para 25.

must thus, be treated as an unsecured creditor in relation to pre-commencement claims.<sup>176</sup>

To annotate more on this position, it must be state that the Taxation Laws Amendment Bill of 2012, gives recognition to the fact that the current tax systems may act as an impediment to the recovery of companies in financial distress where the economic benefit of debt relief is likely to be undermined by the consequent negative tax implications.<sup>177</sup>

While there are a number of jurisdictions where the moratorium under a business rescue model does not affect the rights of secured creditors, like the position of taxation bodies or authorities, more and more jurisdictions have realised the need for secured creditors to be included under a moratorium. The reason for this is that if the secured creditors are allowed to freely exercise their rights in terms of the security they hold, this may frustrate the objectives of a business rescue proceeding.<sup>178</sup>

### **3.5 BUSINESS RESCUE AND CORPORATE GOVERNANCE**

The King III Code of Governance Principles for South Africa places a significant emphasis on business rescue and this is the position in South Africa. In actual scheme of things, the King III Report and the Code are applicable to all forms of corporate entities incorporated in and resident in South Africa.<sup>179</sup>

In the most common definition, corporate governance is generally understood to mean the manner or rather the system in which companies are administered, directed and controlled in context.<sup>180</sup> The boards play a significant role in the face of being the focal point and the custodian of corporate governance.<sup>181</sup>

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<sup>176</sup> Seligson op cit note 155 at 19

<sup>177</sup> Proposed Tax Amendments will assist business rescue, taxtalk 41 jan/feb available at <http://www.sabinet.co.za/sa-e-publications-article> accessed on 4 June 2015

<sup>178</sup> Burdette op cit note 147

<sup>179</sup> Cassim et al Contemporary Company Law op cit note 22 At 474

<sup>180</sup> Investopedia, the definition of corporate governance available at <http://www.investopedia.com/terms> accessed on 20 June 2015

<sup>181</sup> Institute of Directors of Southern Africa, King III Report available <http://www.iodsa.co.za/?kingIII> at accessed on 8 April 2015

Notably, the importance of the relationship between business rescue and corporate governance should be considered. The importance of this relationship can be partially explained by a reflection on the reasons for corporate governance itself. It must be stated here that corporate governance plays an important role in business rescue.

Corporate governance plays an important role in business rescue particularly when one considers the importance of the relationship between business rescue and corporate governance in South Africa. The importance of this relationship can be partially explained by a reflection on the reasons for corporate governance itself.

In the context of business rescue, corporate governance serves to ensure that the board of a company appreciates the nature and purpose of the new obligations particularly to conform to the provisions of business rescue proceedings as contained in the Companies Act. Ultimately, it is important to acknowledge that business rescue necessitates an imperative revolution of culture to commercial renewal and recovery as opposed to the old tradition of corporate liquidation.<sup>182</sup>

In addition, it must be borne in mind that corporate governance has several practical, philosophical and ethical benefits. The importance of this is to ensure that the boards (and directors individually) recognise their new obligations, both to conform with chapter 6 of the Act, business rescue, proceedings under the Act and to accept that this is emerging legislation and requires a change in culture from corporate liquidation to commercial renewal and recovery.<sup>183</sup>

The King III Report makes some notable pronouncements in its wider view and understanding of the importance of business rescue together with its implications. Firstly, it provides that boards should appreciate the essence of being sufficiently headstrong and be quickly resolute in addressing distressed trading situations.<sup>184</sup>

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<sup>182</sup> Ibid

<sup>183</sup> Ibid

<sup>184</sup> Ibid

Secondly, the board should appreciate the importance of being readily available to entertain an early intervention in cases of declined and threatening trading situations.<sup>185</sup> This stems from the fact that early and timeous interventions have the likely effect of preventing further distress. Hence, it identifies the root problems causing financial distress and enables the management to deal with such problems promptly before the situation is aggravated.

Thirdly, the board should exhaust all possible turnaround strategies and opportunities proactively, before the company becomes susceptible to being financially distressed as contemplated in the Act.<sup>186</sup> This clearly requires that every reasonable strategies which can increase the likelihood of the company to remain solvent and to perform viably should be exhausted by all means.

In addition, the boards must be fully conversant with various obligations, particularly to initiate business rescue proceedings and to take positive actions in the event the proceedings for business rescue have been unleashed by the affected persons as provided for in the Act.<sup>187</sup> This clearly should range from procedures and regulations which must be observed in the event where there has been a commencement of business rescue proceedings.

Thus, the boards ought to acknowledge and respect the role and the legal authority of the business rescue practitioner.<sup>188</sup> They must foster an understanding of their duty to be co-operative with the business rescue practitioner from the preparation of the business rescue plan till the execution of the said business rescue plan.<sup>189</sup> In clear terms, the boards must in fact acknowledge that a business rescue practitioner is a temporary supervisor in its substitution.<sup>190</sup>

It is important to also point out that, corporate governance plays a significant role in the administration of business rescue and is definitely a guiding tool which shapes the

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<sup>185</sup> Ibid

<sup>186</sup> Ibid

<sup>187</sup> Ibid

<sup>188</sup> Ibid

<sup>189</sup> Ibid

<sup>190</sup> Ibid

attitude of companies with respect to business rescue. Indeed, this has practical benefits which cannot be overlooked or ignored.

### **3.6 CONCLUSION**

The effect of a moratorium as outlined above appears to be the cornerstone of business rescue and should be embraced. However, strong mechanisms must be put in place to ensure that any form of abuse is prevented. The moratorium in question must also not be abused to withhold or infringe employees' rights. This then suggests that the moratorium must both serve and support the company and its employees.

As indicated above, the implications of business rescue on tax should be resolved decisively, in view of the current context which excludes the South African Revenue Services as a preferent creditor where companies are likely to abuse the process for tax evasion purposes. This will not fare well with the purpose of business rescue or the mandate of SARS.

Overall, it is important to note that the full measure of good corporate governance should be properly exercised since the success of business rescue proceedings demands good governance across the board. In the same token, it must be noted that good governance will guard against the abuse of the business rescue procedure. Its impact on business rescue should normally be noted from the day the board elects or appoints a business rescue practitioner.

## **CHAPTER FOUR: AN OVERVIEW OF THE SUCCESS OF BUSINESS RESCUE**

### **4.1 INTRODUCTION**

This chapter provides a strategic overview of the progress and status of business rescue in South Africa in order to consider the viability of business rescue. Therefore, this part of the study critically examines the success or limitations of business rescue in South Africa in an attempt to locate problem areas and suggest improvements and reforms where so needed.

Business rescue is most significantly concerned about the recovery and rehabilitation of financially distressed companies. There are a number of statistical authorities which one can cite to examine and illustrate the extent of progress or limitations of business rescue. There is a need to make a reflection on the statistical overview of business rescue. For this purpose, considerations should be given to the statistical authorities such as, the Companies and Intellectual Property Commission Annual Report of 2014<sup>191</sup> and the Companies and Intellectual Property Commission Report on the Status of Business Rescue Proceedings in South Africa of 2015.<sup>192</sup> Furthermore, Statistics South Africa's Statistical release of Statistics of Liquidations and Insolvencies of 2015,<sup>193</sup> since the introduction of business rescue was meant to shun away from liquidation

In addition, a consideration will be given to certain views expressed by experts and commentators in the field of business rescue. This will indicate whether the introduction of business rescue has lived or will live to its expectant purpose.

#### **4.1.1 The 2014 Annual Report of the CIPC**

A careful consideration of the various comments made by Dr Rob Davies, the Minister of Trade and Industry in the 2014 Annual Report, clearly suggest that the promulgation

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<sup>191</sup> Companies and Intellectual Property Commission Annual Report 2013/2014(hereinafter referred to as the 2014 Annual Report)

<sup>192</sup> Companies and Intellectual Property Commission report on Status of Business Rescue Proceedings in South Africa 2015 (hereinafter referred to as the 2015 Status Report)

<sup>193</sup> Statistics of liquidations and insolvencies 2015, Statistics South Africa, Statistical release P0043(herein after referred to as the 2015 Statistics of Liquidations)

of the new Companies Act brought about a positive impact in the corporate landscape, particularly by initiating a new course of action for ailing companies.<sup>194</sup>

This view posits that over the past few years it has become clear that the provisions of the Act together with their objectives were well constructed and useful for South Africa.<sup>195</sup> It was nevertheless noted that even though a number of deficiencies are surfacing up with the implementation of business rescue, the regime has as of now exhibited successes.<sup>196</sup> For this reason, it was conceded that numerous provisions required refinement and fine tuning.<sup>197</sup>

However, it is not clear if the provisions of business rescue are part of the provisions which required the said refinement.as it was shown in the earlier chapters that business rescue has exhibited some unforeseeable implications, particularly in the area of taxation and corporate governance. It is submitted here that the provisions of business rescue would for some reasons be part of the provisions which ought to receive some considerable degree of refinement and fine tuning.

In light of the above aspirations by the Minister, he optimistically concluded that, “*South Africa is moving closer to the world class implementation of the Companies Act, I am pleased to note the progress that has been made and look forward to further successes in the year to come*”.<sup>198</sup> He also highlighted that “*the CIPC will be conducting research in the next financial year to test the actual success of these proceedings*”.<sup>199</sup> This was clearly a reference to the year 2015 since the annual report was tendered in the year 2014.

#### **4.1.2 The 2015 Status Report of the CIPC**

As indicated above, the Minister made a promise that the CIPC will be taking a quest in the subsequent financial year so as to consider the actual success of business rescue

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<sup>194</sup> See p 1.4 of the 2014 Annual Report

<sup>195</sup> See p 1.4 of the 2014 Annual Report

<sup>196</sup> See p 1.4 of the 2014 Annual Report

<sup>197</sup> See p 1.4 of the 2014 Annual Report

<sup>198</sup> See p 1.4 of the 2014 Annual Report

<sup>199</sup> See p 1.4 of the 2014 Annual Report, read the Ministers last sentences in the foreword.



proceedings in South Africa.<sup>200</sup> It is assumed here that the 2015 Status Report was solely the fulfillment of Minister's foregoing words in the 2014 Annual Report.

It would appear that the purpose of the status report in essence was to provide an analytical scrutiny on the status or progress of business rescue proceedings within South Africa.<sup>201</sup> It is evident that the report covers the period since the promulgation of business rescue in South Africa till the end of March, that is; the period from 1 May 2011<sup>202</sup> to 31 March 2015.<sup>203</sup>

It is vital to note that, the report excluded or rather disregarded invalid filings, which were irregular or not compliant with the legislative framework and regulations.<sup>204</sup> This was so, since in such instances business rescue proceedings never commenced at all.<sup>205</sup>

#### **4.1.2.1 The business rescue proceedings status**

From the period from 1 May 2011 to 31 March 2015, there have been a total of 1654 business rescue proceedings. It should be noted that, from the 1654 cases when business rescue commenced, 167 cases became nullity, 226 cases have been terminated by a Notice of Termination, 211 cases have been substantially implemented by filing a Notice of Substantial Implementation, 155 cases ended up directly in liquidation, and 12 cases were set aside by the courts.<sup>206</sup>

#### **4.1.2.2 The business rescue per entities**

It appears that, out of the 1654 cases of business rescue proceedings, 1047 were private companies and followed by 523 cases which were close-corporations. In the

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<sup>200</sup> Ibid

<sup>201</sup> See the 2015 Status Report At 1

<sup>202</sup> The date on which business rescue received statutory force in South Africa.

<sup>203</sup> See the 2015 Status Report At 1

<sup>204</sup> See the 2015 Status Report At 1

<sup>205</sup> See the 2015 Status Report At 1

<sup>206</sup> Status report page 1

same token, 78 were public companies, 5 were incorporated companies while non-profit companies only recorded 1 case in business rescue proceedings.<sup>207</sup>

What these figures mean is that private companies are the majority participants in business rescue proceedings, with 63% followed by a 32% from the participation of close corporations. It would appear that business rescue is utilised by private companies and close corporations at a higher rate, a sign which is good for the model of business rescue.

#### **4.1.2.3 Business rescue per province**

It is also convenient to consider the provincial boundaries upon which business rescue operated from the past four years since its inception. However, for convenience and other issues concerning brevity, only the top three provinces will be considered here. It should also be stated that, there were other cases of business rescue for which the provincial location was not provided for.

Notably, 590 cases of business rescue proceedings were recorded in Gauteng, accounting for 53% in all business rescue proceedings.<sup>208</sup> This is likely to be induced by the fact that Gauteng is regarded as the economic hub of South Africa, therefore it has the highest number of companies being incorporated every now and then.

A total of 196 cases of business rescue proceedings were resident within the Western Cape which actually accounted for 17%.<sup>209</sup> On the other hand, 94 were from KwaZulu Natal, which accounted for 8% of the total percentage.<sup>210</sup>

#### **4.1.3 Liquidations in South Africa**

Liquidation refers to the winding-up of a company or close corporation when its fairly estimated liabilities exceed its fairly estimated assets at a particular time, thus it can be undertaken by a voluntary or compulsory process.<sup>211</sup>

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<sup>207</sup> Status report page 2

<sup>208</sup> Status report page 5

<sup>209</sup> Status report page 5

<sup>210</sup> Status report page 5

When a company or a close corporation resolves to undertake a liquidation process by own will or accord, this is called a voluntary liquidation.<sup>212</sup> While on the other hand, when a company or a close corporation is placed under liquidation through a court order, this amounts to a compulsory liquidation.<sup>213</sup>

Statistics South Africa (Stats SA) collects administrative information on liquidations from Companies and Intellectual Property Commission and the Department of Trade and Industry.<sup>214</sup> It is important to state that, the purpose of the statistics of liquidations is to measure economic performance and serves also as an important indicator of the scope of unpaid debt in South Africa.<sup>215</sup> From this, it follows that in the case of attempting to measure the successes or shortfalls of business rescue in South Africa, a consideration of liquidation statistics needs to be taken.

#### **4.1.3.1 Total liquidation**

Total liquidation includes both companies and close corporations. For the sake of convenience, company figures account for close corporations, public and private companies. In South Africa, the total number of liquidations in 2011 was 3559<sup>216</sup>, of which 381<sup>217</sup> were compulsory liquidations and 3178<sup>218</sup> were voluntary liquidations. In the year 2014, the total number of liquidations amounted to 2064<sup>219</sup>, out of which 366<sup>220</sup> were compulsory liquidations and 1698<sup>221</sup> were voluntary liquidations.

What these figures bring to light is that there has been a considerable decrease of the total liquidations from 2011 to 2014. Based on the figures outlined above, one may come to a percentile conclusion that, from 2011 to 2014, the number of total liquidations decreased by 42 %.

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<sup>211</sup> See the 2015 Statistics of Liquidations at 9

<sup>212</sup> See the 2015 Statistics of Liquidations at 9

<sup>213</sup> See the 2015 Statistics of Liquidations at 9

<sup>214</sup> See the 2015 Statistics of Liquidations at 9

<sup>215</sup> See the 2015 Statistics of Liquidations at 9

<sup>216</sup> Table 2 2015 Statistics of Liquidations

<sup>217</sup> Table 2.1 of the 2015 Statistics of Liquidations

<sup>218</sup> Table 2.2 of the 2015 Statistics of Liquidations

<sup>219</sup> Table 2 of the 2015 Statistics of Liquidations

<sup>220</sup> Table 2.1 of the 2015 Statistics of Liquidations

<sup>221</sup> Table 2.2 of the 2015 Statistics of Liquidations

This suggests, that since the introduction of business rescue in South Africa, liquidations are no longer common among South African corporate entities. In addition to this view, it can be assumed that the courts have not preferred to order liquidations since most financially distressed companies opted for the business rescue road long even before creditors could apply for liquidations.

However, the 42% decrease in liquidations does not automatically mean that companies pursued the business rescue road, since there are other relevant circumstances which might have played a role in this decrease in the exclusion of business rescue. It is possible that other companies pursued the compromise procedure which is provided for under the banner of the new Companies Act which might have still been in place when the aforementioned figures were compiled.<sup>222</sup> Other companies might have managed to secure extra capital which would have induced a relief from financial distress.

#### **4.1.3.2 Total liquidation of companies**

Here a consideration is only given to companies to the exclusion of close corporations. Close corporations will be considered separately in a discussion later on. Under total liquidation, companies will include both private and public companies. In 2011, the total number of companies which were thrown in the liquidation arena was 1606<sup>223</sup>, of which 220<sup>224</sup> were compulsory liquidations while 1386<sup>225</sup> were voluntary liquidations.

In the year 2014, the total number of companies which saw the wrath of the liquidation platform was 1028<sup>226</sup>, in the sense that only 222<sup>227</sup> were compulsory liquidations while the remaining 806<sup>228</sup>, were voluntary liquidations. A proper analysis in these liquidation figures indicates that almost 78% of company liquidations occurred by way of voluntary liquidations in the year 2014.

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<sup>222</sup> See Part E of Chapter 6 of the Companies Act, particularly Section 155 of the Companies Act which makes provision for the compromise with creditors. Compromise with creditors is a separate procedure from business rescue and therefore it shall not be dealt with in this paper, hence it is out of the scope of this paper.

<sup>223</sup> Table 3 of the 2015 Statistics of Liquidations

<sup>224</sup> Table 3.1 of the 2015 Statistics of Liquidations

<sup>225</sup> Table 3.2 of the 2015 Statistics of Liquidations

<sup>226</sup> Table 3 of the 2015 Statistics of Liquidations

<sup>227</sup> Table 3.1 of the 2015 Statistics of Liquidations

<sup>228</sup> Table 3.2 of the 2015 Statistics of Liquidations

This kind of situation cannot go without questions and concerns. In fact, it creates a room to assume that companies doubt the business rescue procedure. In a larger sense, it stimulates questions about whether companies are aware of the existence of business rescue provisions in South Africa or not and why 78% of companies voluntarily prefer liquidation over business rescue. These are not only worrying questions but they are also relevant in a quest to consider the viability of the business rescue model in South Africa.

According to Alex Elliott, an insolvency and business rescue expert, “*business rescue is something that the government, trade unions, private business and other stakeholders grapple with*”.<sup>229</sup> He goes further to say “*just because a company goes into business rescue, it does not mean it should be rescued, some companies deserve to fail, and not every business is a good business*”.<sup>230</sup> This statement could account for the reasons why 78% of companies would drive away through the liquidation rail, on account that, they deserve to fail or they are not good businesses.

In addition to the view outlined above, what this situation indicates is that banks usually find advancing working capital to companies in business rescue, referred to as post-commencement finance, too risky unless the loan is secured.<sup>231</sup> When claiming its money back, the financier is ranked below the business rescue practitioner and the organisation’s employees if the rescue should fail.<sup>232</sup> Therefore, companies which are failing to secure the so called post-commencement finance are likely to consider voluntary liquidation.

One of the fairly recent examples of this nature is with reference to Chemspec, a paint and coatings company.<sup>233</sup> In or around March 2015, the company became financially distressed in that, the previous year the company negotiated with its large investors to

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<sup>229</sup> Thekiso Anthony Lefifi “Why most business rescue processes are failing” Business Day live, 11 November 2012 at 1

<sup>230</sup> Ibid

<sup>231</sup> Ibid

<sup>232</sup> Ibid

<sup>233</sup> Nick Hedley “Chemspec pursues voluntary business rescue” Business Day live 11 March 2015 at 2

inject more capital as it would need new capital in 2015.<sup>234</sup> Unfortunately, these negotiations were not successful and the expected financial support was declined.<sup>235</sup>

As a result Chemspec announced its intentions to pursue business rescue, however it was to engage with potential funders in respect of post-commencement finance.<sup>236</sup> From this, it follows that if it fails to secure post-commencement finance, then it would voluntarily surrender to liquidation.

The above-mentioned scenario clearly indicates that business rescue in South Africa comes with certain latent or rather inherent conditions. Despite the fact of having a company which met all the requirements to commence with business rescue, such a company may still pursue voluntary liquidation on the contrary of opting for the business rescue process, for the most part, precisely because of these latent or inherent conditions.

These latent or inherent conditions range from various factors. Firstly, a company being unable to secure the necessary post-commencement finance which should assist the company during the subsistence of the business rescue process, secondly, the company being unable to secure the services of a suitable business rescue practitioner.

It is submitted here that, the most viable model of business rescue is one which will clearly enable every company, small or big, to undertake the business rescue road despite the presence of the implications of the aforementioned latent conditions which are likely to induce the company to surrender to liquidation. It is not misleading to assert that, what the statistics outlined above is a sad case for South Africa which cannot go without problems. If what the liquidation statistics have indicated is to be welcomed as an achievement, then in that case, it would seem that business rescue is not fully aimed at rescuing all financially distressed companies and this will be broadly at odds with the spirit and the object of business rescue.

#### **4.1.3.3 Total liquidation of close corporations**

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<sup>234</sup> Ibid

<sup>235</sup> Ibid

<sup>236</sup> Ibid

It is important to also consider the liquidations of close corporations since they are also covered under the business rescue provisions. A point worth noting is that the introduction of the new Companies Act abolished the formation of close corporations. However, all the close corporations established prior to the promulgation of the new Companies Act are still regulated as such. Therefore, the close corporations referred to in here are the ones established prior to the enactment of the new Companies Act.

In the year 2011, a total number of 1953<sup>237</sup> close corporations were liquidated, of which 161<sup>238</sup> were compulsory liquidations and 1792<sup>239</sup> were voluntary liquidations. In the year 2014, about 1036<sup>240</sup> close corporations were liquidated, 144<sup>241</sup> were compulsory liquidations and 892<sup>242</sup> were voluntary liquidations.

#### **4.1.3.4 Liquidations of companies per industry**

It is important to take a quick and brief reflection on the industries which were affected at most by the aforementioned liquidations on companies. In 2014, the financing, insurance and business service industry was the highest victim of the liquidations, with 465<sup>243</sup> liquidations. It was followed by the community, social and personal services industry which recorded 246<sup>244</sup> liquidations.

It is submitted here, that the highest number recorded by the financing, insurance and business industry is likely to have a negative impact on the success of business rescue in South Africa. In that, firstly companies undertaking business rescue should in most cases secure a post-commencement finance. It is of common fact that post-commencement finance is usually sought from the financing industry. Now that the financing industry is being liquidated at a higher rate, this will hinder the prospects of financially distressed companies to secure post-commencement finance.

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<sup>237</sup> Table 4 of the 2015 Statistics of Liquidations

<sup>238</sup> Table 4.1 of the 2015 Statistics of Liquidations

<sup>239</sup> Table 4.2 of the 2015 Statistics of Liquidations

<sup>240</sup> Table 4 of the 2015 Statistics of Liquidations

<sup>241</sup> Table 4.1 of the 2015 Statistics of Liquidations

<sup>242</sup> Table 4.2 of the 2015 Statistics of Liquidations

<sup>243</sup> Table 1.1 of the 2015 Statistics of Liquidations

<sup>244</sup> Table 1.1 of the 2015 Statistics of Liquidations

Secondly, one troubling issue should be analysed from the higher liquidations in the insurance industry. This should serve as a concern in that, in most situations a company which has insured its assets through a particular insurer is likely to suffer more if the insurer is to face the wrath of liquidation.

This stems from the worst case scenario which is to be found in a possible case where the insurer is facing liquidation and at the same time the insured company suffers a peril or harm which has been insured by the insurer who is facing liquidation. From this, it follows that this situation can induce the possibility of financial distress to a company insured by an insurer who is facing liquidation.

#### **4.1.3.5 Liquidations of close corporations per industry**

In 2014, with regard to close corporations, the industry which suffered most was the financing, insurance and business services. It actually recorded about 390<sup>245</sup> liquidations, which is almost 50% of the companies in the industry. In the rankings, it was followed by the wholesale, retail and trade industry which had 290<sup>246</sup> liquidations attached to it.

The industry which accumulated the lowest liquidations was the mining industry with only 5<sup>247</sup> liquidations. It was thus, followed by the agriculture industry with only 9<sup>248</sup> liquidations.

Lastly, Business-rescue statistics have shown a relatively poor turnaround success rate, but awareness and knowledge among businesses, creditors and business-rescue practitioners are growing.<sup>249</sup> In addition to what has been outlined above, one will notice the positive decrease which has been shown in the liquidation statistics. Indeed, this can and will contribute positively to the success rate of business rescue in the future.

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<sup>245</sup> Table 1.2 of the 2015 Statistics of Liquidations

<sup>246</sup> Table 1.2 of the 2015 Statistics of Liquidations

<sup>247</sup> Table 1.2 of the 2015 Statistics of Liquidations

<sup>248</sup> Table 1.2 of the 2015 Statistics of Liquidations

<sup>249</sup> Brendan Peacock "Luxury estates rise from an unplayable position" Business Day live 26 January 2014 at 1



## **4.2 THE BUSINESS RESCUE QUESTION AND CONCERN FOR SOUTH AFRICA**

### **4.2.1 Does business rescue bear relevance in South Africa?**

Business rescue as a mechanism of saving and recuperating companies which are financially distressed is highly relevant in an economy like that of South Africa. In jurisprudential terms, an economy which largely relies on companies for its ultimate growth has everything to lose if it does not provide mechanisms to serve and support the sustainability and perpetuity of such companies.

It is precisely fair to observe that business rescue in its entirety is one such a mechanism which seeks to serve and support the sustainability and perpetuity of companies by efficiently rescuing them during times of financial distress, let alone the employment of the vast population by the corporate sector. For this reason alone, rescuing companies from liquidation and corporate closure ultimately guards against job losses and this on its own serves the South African economy very well.

## **4.3 CONCLUSION**

Despite having slightly positive results on the outcome of the introduction of the business rescue in South Africa as demonstrated by the reduced number of liquidations as provided by statistics South Africa and the ultimate success rate as put to us by the CIPC, much is still desired. The performance of business rescue calls for a further modification. This will certainly contribute to the success rate of business rescue. If the increase of the success rate of business rescue will have a positive impact on many people, particularly those who are dependent on the company for their livelihoods and survival, this on its own will boost the South African economic growth and economic development.

## **CHAPTER FIVE: RECOMMENDATIONS AND CONCLUSION**

### **5.1 RECOMMENDATIONS**

This mini-dissertation recommends that to enhance the viability of business rescue in South Africa, there should be, a separate Act of business rescue, a separate business rescue commission, uniform education and a formal qualification for business rescue practitioners, formal admission and enrollment of business rescue practitioners, strict prohibition of insolvent trading and fixed litigation fees and costs for business rescue proceedings.

#### **5.1.1 A separate Business Rescue Act**

There should be a separate business rescue legislation which will specifically deal with business rescue. This will be the best position for South African companies' business environment. A separate Act will generally induce business rescue to be free from misinterpretation since business rescue will now be uniformly interpreted in light of its own sole provisions and objects aside from the wider field of company law.

A separate Act will deal away with the difficulties confronting the CIPC at the moment in the administration of company law provisions. Furthermore, it will deal away with the congestion of wide stream provisions, starting from the incorporation, registration and organisation of companies, the capitalisation of profit companies and the registration of offices of foreign companies carrying business within the Republic, amalgamations, mergers and takeovers of companies. It is asserted here that business rescue needs special attention, hence a separate Act will be able to provide such.

#### **5.1.2 A separate Business Rescue Commission**

While it is entirely not desirable to doubt the administrative capacity of the CIPC to administer, deal and handle business rescue, it is important to recommend that a separate business rescue commission should be established to deal holistically with business rescue concerns only. This stems from the foundational observation and the idea that the CIPC, as of now, has a massive mandatory scope emanating from its statutory objectives as outlined in Chapter 8 of the new Companies Act.

If considered on its own, this massive mandatory scope has the likely effect of hindering the CIPC's focus in dealing with and prioritising business rescue. A great deal of observation which ought to be noted with higher relevance is the fact that business rescue requires special attention and proper exercise of decision making from various stakeholders and role players during the subsistence of its process. This includes the business rescue practitioner, the original management of the company, the commission itself and ultimately the courts. To annotate more on this is the special attention which must be given to the business rescue plan itself. It would be more convenient if business rescue is administered separately by a commission other than the CIPC.

### **5.1.3 A uniform education and a national formal qualification for business rescue practitioners**

It has been widely acknowledged that the introduction of business rescue in South Africa has brought about a new profession or a new field of specialisation. Since this is the case, it is recommended that there be a uniform education for all business rescue practitioners who should induce the introduction of a national qualification. This will be of utmost help for all business rescue practitioners to have the same understanding of what financial distress entails, what business rescue entails and what strategies should be enforced on a particular company.

### **5.1.4 Formal admission and enrollment of business rescue practitioners**

One must acknowledge that the current business rescue model in South Africa only empowers a person to be a business rescue practitioner through a temporary license. It is important here to indicate that this on its own will have shortfalls in respect of the necessary regulation for business rescue practitioners. In fact, it will make the regulation of business rescue practitioners hard if not impossible because there is no specific number of people who are business rescue practitioners in South Africa, precisely because of this temporary licensing scheme.

One of the benchmarks and successes of the business rescue industry is deeply rooted in the proper regulation of business rescue practitioners. Therefore, just like all professions such as the legal, social work, accounting and medical fraternities, business

rescue practitioners should be admitted and enrolled as such for as long they are fit and proper to be business rescue practitioners at any time.

#### **5.1.5 Strict prohibition of insolvent trading**

One of the foundational reasons for companies to be financially distressed in South Africa is to be deduced partially from the fact that companies have the propensity of trading while commercially insolvent. This can partly be accounted for by the lack of a strict prohibition on insolvent trading.

In this regard, the law should prohibit companies from trading if such companies are commercially insolvent. In other words, if a company is commercially insolvent, it must be given a peremptory corporate obligation to apply for business rescue at the immediate stance. To let a company perpetuate on trade while it is commercially insolvent will virtually subject the said company to an irreparable financial distress which might make it more difficult for it to be a good candidate or succeed in the business rescue process.

#### **5.1.6 Fixed litigation fees and costs for business rescue proceedings**

One of the recognitions here, is that the court based system as adopted in South African jurisdiction will often lead to delays and costly litigation that would eventually result in even smaller dividends for creditors. To avoid the dissipation of the company's remaining funds in litigation activities, there should be a fixed fees framework for litigation. This should be viewed in compelling legal practitioners to charge fees at a particular prescribed scale for business rescue purposes.

### **5.2 CONCLUSION**

One of the most fundamental objectives of the Companies Act 71 of 2008 is to provide for efficient rescue of financially distressed companies. As stated above, it is almost four years since the provision for business rescue in South Africa was made. The industry has seen its partial outcomes, shortcomings and other far reaching implications, particularly in the area of taxation and corporate governance.

It must be stated that the dawn of business rescue in South Africa emerged at a time of immense corporate struggles, for example struggles relating to liquidations and business failures as induced by the global economic recession which has negatively affected South Africa's economic performance levels.

Therefore, it can be concluded that the laws regulating business rescue in South Africa have been developed in such a way that they give the business rescue practitioner a role to have an impact on every aspect of the company, including the implementation of the approved and adopted business rescue plan. For this reason, it is important that the original management of the company serve and support every reasonable initiative taken by the business rescue practitioner.

A review of trends and developments in the national corporate arena, suggest that business rescue has become the focal point of many contemporary companies. In essence, there is a clear shift towards a more debtor-friendly system which should be hailed as a much needed theme for South Africa to deal with corporate failures and business decline.

In South Africa, business rescue has tried to positively influence so many lives in the society. However, the sentiments of Dr Rob Davis about business rescue should be seen as reiterating a renewed commitment to view business rescue as an essential ingredient in a democracy which has more focus on economic growth and economic development.

Thus, the courts should rise to their task of interpreting business rescue provisions so as to fulfil all the purposes of business rescue as envisaged in the Companies Act. For this reason, the courts must be acknowledged for every attempt which has been directed towards shaping the image of business rescue in South Africa.

Despite the foregoing figures of a 12% success rate of business rescue in South Africa, it should be emphasised that South Africa should try to increase this success rate, so as to ensure that the South African model of business rescue comes to par with other civilized comparable jurisdictions such as Belgium and the United States of America.

However, to achieve a higher success rate, South Africa would also need to decrease the number of insolvencies and liquidations on a yearly basis.

While the CIPC has set down clear core principles, mechanisms and processes that are necessary to enable financially distressed companies to move progressively towards a stress free financial status, the study concludes that, it may well be in the interest of efficient rescue of financially distressed companies that the CIPC provide a stronger and viable mechanism that will ensure that the affected companies become fully functional entities in the long run. This will contribute massively to the economic upliftment of the local communities within which the companies do business. As a result, this will provide access to the essential services that are provided by the company at hand.

It is noteworthy to state that the business rescue plan must focus on the critical capabilities needed to restructure the company. In addition, it should also be noted that attaining these capabilities will never be automatic, nor is it a simple task to reckon with. If a company is financially distressed, it is logical that its status is likely to induce a sense of high levels of frustration, particularly among the directors and shareholders including to the business rescue practitioner. This situation clearly suggests that time is of paramount importance when developing or executing a business rescue plan.

Since well business rescue encompasses the engagement of affected persons in the affairs of the company, it must as well satisfy the need to create a more harmonious relationship among the company, employees, shareholders and the local communities. Thus, the introduction of business rescue is appropriate to the needs of a modern South African economy.

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