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JUDICIAL IMPLEMENTATION OF SOUTH AFRICA'S NEW BUSINESS RESCUE MODEL: A PRELIMINARY ASSESSMENT*

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INTRODUCTION

One of the most exciting and innovative aspects of South Africa's New Companies Act[1] ("the 2008 Companies Act" or "the Act") is the creation of a new business rescue model in Chapter Six of the Act ("Chapter Six"). The scheme of Chapter Six of the 2008 Companies Act[2] replaces the judicial management model that was contained in the 1973 Companies Act,[3] which is the predecessor of the current Act. Like most major pieces of legislation enacted in post-apartheid South Africa, the 2008 Companies Act in general, and Chapter Six in particular, are intended by the legislature to significantly enlarge the capacities of both the government and the private sector

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1 Companies Act 71 of 2008 (S. Afr.). Unless otherwise indicated, all references to statutory provisions are references to provisions of this Act. Although enacted in 2008, the Act only came into force on May 1, 2011. Pursuant to powers conferred under the Act, the Minister of Trade and Industry has enacted The Companies Regulations, 2011 which are expected to assist both the application and implementation. See GN R351 in GG 34239 of 26 April 2011 (S. Afr.).

2 Companies Act 71 of 2008 Chapter Six (S. Afr.).

3 Companies Act 61 of 1973 (S. Afr.). The 1973 Companies Act has now been repealed by the 2008 Companies Act.

to preserve existing jobs, create new employment opportunities, and make the country's economy competitive relative to its contemporaries.[4] But beyond the purely economic policy objectives, the 2008 Companies Act was also intended to infuse the regulatory framework governing companies with the treasured democratic values of equality, non-racialism, and human dignity enshrined in South Africa's post-apartheid Constitution.[5]

The fact that both social and economic objectives impelled the enactment of the 2008 Companies Act and Chapter Six can be gleaned from the twelve objects of the Act set out in section 7. With particular respect to Chapter Six, it is specifically stated that part of the policy intent behind the enactment of the Act is "to provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders."[6] Especially significant is the provision of section 5(1) of the 2008 Companies Act, which explicitly enjoins the courts to interpret and apply the provisions of the Act in a manner that gives effect to the purposes set out in section 7. Based on the provisions of sections 5, 7, and Chapter Six, both judges and academics[7] are in agreement that the legislature has unequivocally signalled its preference for the rescue of financially distressed companies as against liquidation.[8] Both the 2008 Companies Act and Chapter Six constitute another glaring example of South Africa's attempt to use commercial legal regulatory instruments

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4 SOUTH AFRICAN COMPANY LAW FOR THE 21ST CENTURY: GUIDELINES FOR CORPORATE LAW REFORM, GENERAL NOTICE 1183, ¶ 1.2 (2004), available at http://www.gov.za/sites/www.gov.za/files/26493_gen1183a.pdf.

5 S. AFR. CONST., 2008.

6 Companies Act 71 of 2008 § 7(k) (S. Afr.).

7 CONTEMPORARY COMPANY LAW 861-64 (Farouk H.I. Cassim et al. eds., 2d ed. 2012); 1 HENOCHSBERG ON THE COMPANIES ACT 71 OF 2008 44-46 (Piet Delport et al. eds. 2012) [hereinafter "DELPORT"].

8 This point was made most distinctly by the court in *Koen and Another v. Wedgewood Village Golf and Country Estate Ltd.* 2012 (2) SA 378 (WCC) at para. 14 (S. Afr.) as follows: "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. It is obvious that it is in the public interest that the incidence of such adverse socioeconomic consequences should be avoided where reasonably possible. Business rescue is intended to serve that public interest by providing a remedy directed at avoiding the deleterious consequences of liquidations . . . ."

to boost socio-economic transformation by creating conditions that will enable significantly increased participation of the formerly disenfranchised black majority in the mainstream economy. These reforms will help the society overcome the multiple legacies of apartheid with which South Africa continues to struggle twenty years into the democratic era.

The quality of real or tangible outcomes achieved by statutory regulatory instruments generally, and commercial law-related instruments in particular, may depend in part on their interpretation and application by the courts.[9] To be sure, the adoption of an interpretive approach that is conservative, largely textual or literal, and purpose-neutral will significantly undermine the prospect of Chapter Six achieving the public policy goals intended by law and policymakers. Indeed, such an approach may by itself lead to regulatory failure.[10] The plausibility of this concern is clearly borne out by the experience of "judicial management" in the courts. In this respect, it is especially noteworthy that virtually all of the academic and judicial post-mortem done on the judicial management scheme of the 1973 Companies Act suggest that one of the main reasons for the dismal failure of that scheme was the conservative judicial approach to the interpretation and application of the requirement of "reasonable probability" (of successful financial rehabilitation of the debtor company), which was a prerequisite for the granting of a judicial management order under section 417 of that Act.[11] The risk of business rescue suffering the same

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[9] COMPARATIVE COMPANY LAW: A CASE-BASED APPROACH 378-79 (Mathias Siems & David Cabrelli eds. 2013).

[10] Such failure would almost certainly become reality if the courts adopt a disposition and develop a jurisprudence that is generally "creditor-friendly," as was the case in the judicial management era and as is still the case under the country's insolvency law and related processes. It should be noted here that judicial management was first introduced into South African law through the Companies Act of 1926 and only became consigned to history when the 2008 Companies Act came into force. *See* Richard Bradstreet, *The New Business Rescue: Will Creditors Sink or Swim?*, 128 SALJ 352, 353-56 (2011); Anneli Loubser, *The Role of Shareholders during Corporate Rescue Proceedings: Always On the Outside Looking In?*, 20 SAMLJ 372, 372-73 (2008).

[11] *See, e.g.*, David Burdette, *Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 1)*, 16 SAMLJ 249 (2004); CONTEMPORARY COMPANY LAW, *supra* note 7, at 2; Pieter Kloppers, *Judicial Management Reform – Steps to Initiate a Business Rescue*, 13 SAMLJ 358 (2001); *Koen and Another v. Wedgewood Village Golf and Country Estate Ltd.* 2012 (2) SA 378 (WCC) at 2

fate in the courts as its judicial management predecessor is significantly heightened by the deficiencies of the 2008 Companies Act generally and of Chapter Six in particular.[12]

Against the above background, it is clear that the interpretive approach and attitude of the courts will be critical to the efficacy of the Chapter Six rescue mechanism and, therefore, to the attainment of the underlying public policy objectives. Without doubt, if they adopt an

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(S. Afr.); Anneli Loubser, *Judicial Management as a Business Rescue Procedure in South African Corporate Law*, 16 SAMLJ 137 (2004); *Oakdene Square Properties Ltd. and Others v. Farm Bothasfontein (Kyalami) Ltd. and Others* 2013 (4) SA 539 (S. Afr.); *Propspec Investments Ltd. v. Pacific Coast Investments 97 Ltd.* 2013 (4) SA 539 (S. Afr.). Other factors that have been identified include the absence of a business rescue culture among all the various role players (creditors, judges, etc.) and the fact that judicial managers were usually chosen from the ranks of liquidators who have neither the skill nor experience in rehabilitating businesses. *See* 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*, 22 SAMLJ 195, 195 (2010). It would seem that there were also historical factors that lay behind the spectacular impotence and ultimate failure of judicial management. See Anneli Loubser, *Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law*, 25 SAMLJ 437, 438 (2011).

[12] In this respect, the following points are noteworthy. First, consisting of a total of 225 sections and 5 schedules, the 2008 Companies Act is about the shortest contemporary companies' legislation. It can in this respect be sharply contrasted with the United Kingdom 2006 Companies Act, which consists of 1300 sections and 16 schedules; Australia's Corporations Act 2001 made up of 1516 sections and 4 schedules; Hong Kong's Companies Ordinance 2012, which consists of 921 sections and 11 schedules; and India's Companies Act 2013 consisting of 470 sections and 7 schedules. However, the interpretation and application of the Act is supported by the Companies Regulations of 2011 made by the Minister of Trade and Industry pursuant to powers conferred by Companies Act 71 of 2008 § 223 (S. Afr.). As already pointed out by some academic commentators and as the emerging case law is beginning to show, the result of this extreme minimalist approach and economy of content is that several important issues of company law are either not covered at all or are addressed in significantly inadequate detail. *See* CONTEMPORARY COMPANY LAW, *supra* note 7, at 2; PIET DELPORT, THE NEW COMPANIES ACT MANUAL 3-4 (2009); Loubser, *Judicial Management as a Business Rescue Procedure in South African Corporate Law*, *supra* note 11, at 137. Second, the deficit in the width of regulatory coverage is exacerbated by the poor quality of legislative drafting apparent in several parts of the 2008 Companies Act. This has already been the subject of judicial lamentation in the emerging case law. *See also DH Brothers Industries v. Gribnitz NO and Others 2014* (1) SA 103 (S. Afr.) and *Tuning Fork Ltd. t/a Balanced Audio v. Greeff and Another* 2014 (4) SA 521, ¶ 90 (S. Afr.).

approach and attitude similar to that which was consistently visited on "judicial management," there is a real likelihood that the rescue mechanism will fail at the judicial altar. Cognisant of this possibility, this paper examines some of the Chapter Six related decisions and pronouncements made by South African courts in the last three years, with a view to assessing the practical or policy implications of those decisions and pronouncements. The analysis will determine whether the decisions are ultimately favourable to the emergence of Chapter Six as an effective corporate rescue mechanism in South Africa.

I. BRIEF SUMMARY OF THE MAIN FEATURES OF SOUTH AFRICA'S CORPORATE RESCUE MODEL

The scheme of Chapter Six can be activated in either one of two ways. The first is by way of a resolution adopted by the board of directors of a "financially distressed company" where the directors genuinely believe that the company is "financially distressed"[13] and that there is a reasonable prospect of rescue.[14] Alternatively, where the board of such a company appears reluctant to adopt such a resolution, and thereby activates business rescue proceedings voluntarily, any "affected person"[15] may apply to the court for an order placing the

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[13] In terms of Companies Act 71 of 2008 § 128(1)(f) (S. Afr.), a company is "financially distressed" if, within the immediately ensuing six-month period, (a) it appears reasonably unlikely that the company will be able to pay all of its debts as they become due and payable; or (b) it appears reasonably likely that the company will become insolvent.

[14] "Rescuing a company" is defined as the achievement of either one of two goals, namely, (a) the restructuring of the affairs, business, property, equity, debt, and other liabilities of a financially distressed company in a manner that maximizes the likelihood of the company continuing in existence on a solvent basis or, (b) if it is not possible for the company to continue in existence, results in a better return to the company's creditors or shareholders than would result from the immediate liquidation of the company. *See* Companies Act 71 of 2008 §§ 128(1)(b)(iii), 128(1)(h) (S. Afr.).

[15] In relation to a company, the term "affected person" refers to the shareholders or creditors, trade unions representing the company's employees, the employees themselves, or their representatives where they are not represented by a trade union. *See* Companies Act 71 of 2008 §§ 128(1)(a), 144 (S. Afr.). The recognition of trade unions and employees and the vesting of significant rights on them in the corporate rescue context is one of the innovations introduced by the 2008 Companies Act and is consistent with South African law and policymakers'

company under rescue.[16] Irrespective of how the proceedings are commenced, the first major consequence is that the business and affairs are placed under the supervision and control of a "business rescue practitioner" to whom all the "affected persons" must now look for the possible rehabilitation of the company.[17]

The second major legal consequence flowing from the commencement of business rescue proceedings is the moratorium on legal proceedings, executions, and claims (secured and unsecured) against the company.[18] This effectively insulates a company undergoing rescue from legal or enforcement proceedings either pending or in prospect.[19] The moratorium, which is general in its reach, arises both immediately and automatically upon the proper commencement of the said proceedings.[20] While the effect of the moratorium does not extend to an alteration of existing rights acquired by the company's creditors in the period preceding business rescue, it does effectively freeze those rights "in the sense that creditors may not enforce their rights while the company is under the rescue process without the written consent of the business rescue practitioner or in certain circumstances, the court[.]"[21]

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conviction that these particular stakeholders deserve stronger protection in processes and transactions aimed at resolving challenges posed by financially distressed employers. *See* CARL STEIN & GEOFF EVERINGHAM, THE NEW COMPANIES ACT UNLOCKED 411 (2011).

16 Companies Act 71 of 2008 § 129(1) (S. Afr.).

17 In this respect, although the South African business rescue scheme shares several features with the famous 11 U.S.C. § 1101 corporate bankruptcy management regime, it also differs sharply in that it adopts what Professor McCormack has described as a "management displacement model" when compared to the "debtor-in-possession" model of 11 U.S.C. § 1101. *See* GERARD MCCORMACK, CORPORATE RESCUE LAW: AN ANGLO-AMERICAN PERSPECTIVE 80-83, 152-54 (2008). *See also* CONTEMPORARY COMPANY LAW, *supra* note 7, at 861, 866; STEIN & EVERINGHAM, *supra* note 15, at 409.

18 Companies Act 71 of 2008 § 133 (S. Afr.).

19 This feature appears common to most of the corporate rescue schemes in Anglo-American jurisdictions. MCCORMACK, *supra* note 17, at 156-175.

20 CONTEMPORARY COMPANY LAW, *supra* note 7, at 878-79.

21 *Id.* 878-79. In the recent case of *Moodley v. On Digital Media (Pty) Ltd.* 2014 (6) SA 279 (GJ) (S. Afr.), the court held that the scope of the said general moratorium does not extend to legal proceedings brought against a company under business rescue and its business rescue practitioner in connection with the rescue plan,

Perhaps the most crucial part of the business rescue process consists of the development, approval, and implementation of a competent rescue plan.[22] Inevitably, exclusive responsibility for this part of the process is imposed on the practitioner who must begin his tenure by simultaneously investigating the company's affairs and consulting with the creditors, management, employees or their trade unions, and other stakeholders.[23] Following development of the plan, it must be presented for approval of the creditors at a meeting which is also open to participation by other groups of "affected persons."[24] A rescue plan is only "approved" if it is supported by seventy-five percent of the creditors out of which fifty percent must be claimants who qualify as "independent creditors."[25] Implementation of the plan can only be properly embarked upon by the business rescue practitioner if approval has been given in accordance with the requirements of the 2008 Companies Act.[26] If the required level of creditor support for the plan is not received, the rescue proceedings automatically terminate, unless the practitioner or an "affected person" pursues the very limited recourse available to him under the Act.[27]

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including its interpretation and execution towards implementation. In reaching this decision, the court declined to follow an earlier high court decision to the contrary handed down in *Redpath Mining South Africa (Pty) Ltd. v. Marsden No and Others* 2013 ZAGPJHC 148 (GSJ) (S. Afr.).

22 Companies Act 71 of 2008 § 140(1) (S. Afr.).

23 *Id.* § 141(1). However, there is an obligation imposed on directors by Companies Act 71 of 2008 § 142 (S. Afr.) to provide assistance and cooperation to the business rescue practitioner.

24 *Id.* § 152 (S. Afr.). For a detailed discussion of the various stakeholders' participatory rights, see CONTEMPORARY COMPANY LAW, *supra* note 7, at 899-905; and DELPORT, *supra* note 7, at 500-14.

25 The term "independent creditor" is defined by Companies Act 71 of 2008 § 128(1)(g) (S. Afr.) as a creditor, including an employee, who is not related to the debtor company. It specifically excludes the company's directors as well as the business rescue practitioner.

26 *Id.* § 152(5), (6). These provisions impose a mandatory obligation on the debtor company, under the direction of the business rescue practitioner, to take all steps necessary to satisfy any conditions on which the rescue plan is contingent and to implement the plan.

27 Where a plan is rejected by the creditors, there are essentially two options available under Companies Act 71 of 2008 § 153(1) (S. Afr.). The first is for either the business rescue practitioner or an "affected person" to make an application to court for an order setting aside the creditors' negative vote on the basis that it was

II. Assessment of the Emerging Jurisprudence

Since the 2008 Companies Act came into operation on the May 1, 2011, there have been no less than fifteen reported judicial decisions on business rescue applications and resulting or related proceedings. For the purposes of this paper, it is especially significant that business rescue appears to have been granted in only one of the cases that have come before the courts.[28] Consistent with sound judicial practice, the courts have taken the opportunity in each case to make decisions and pronouncements on several questions pivotal in the context of the interpretation, application, and implementation of Chapter Six. In the discussion that follows below, this paper discusses the judicial decisions and pronouncements on some of those questions.

A. What Constitutes a "Reasonable Prospect of Rescue"

The most recurring questions in the emerging case law pertain to the provision empowering a court to grant an order, at the behest of an "affected person," placing a company under business rescue where, *inter alia*, "there is a reasonable prospect for rescuing the company."[29] Not surprisingly, this provision also featured prominently in the two cases on business rescue that have thus far reached the Supreme Court of Appeal ("SCA").[30] The first question that the courts have had to confront in this context, is as to what exactly the legislature meant by the words "reasonable prospect of rescue." Indeed, most of the applications for business rescue made thus far have failed mainly on the ground that the applicants were unable to meet the evidentiary

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"inappropriate." The second option is for an "affected person" or "combination of affected persons" to make an offer to purchase the voting interests of one or more of the opposing creditors at a value independently and expertly determined to be a fair and reasonable estimate of the return to the said creditor(s) if the company were to be liquidated.

[28] That solitary case is *African Banking Corp. of Botswana Ltd. v. Kariba Furniture Manufacturers (Pty) Ltd. and Others* 2013 (6) SA 471 (S. Afr.).

[29] *Id.* § 131(4)(a).

[30] *See Oakdene Square Properties Ltd. and Others v. Farm Bothasfontein (Kyalami) Ltd. and Others* 2013 (4) SA 539 (S. Afr.); and the very recent (and yet to be reported) decision in *Newcity Group (Pty) Ltd. v. Allan David Pellow NO and Others* 2014 ZASCA 162. The SCA of South Africa is the highest court in South Africa for all matters except those raising constitutional questions for which the Constitutional Court (where the Chief Justice sits) is the apex court.

burden implicit in this requirement.[31] For supporters and enthusiasts of business rescue in South Africa, these "pioneering" High Court and SCA judgments[32] must be troubling, partly because of the overwhelmingly negative findings and conclusions which point to the possibility that the courts might be unwittingly setting the bar too high for the applicants and in the process unfairly denying access to the remedial potential of the Chapter Six statutory scheme for financially distressed companies and their stakeholders.[33] In this regard the decision in *Southern Palace Investments (Pty) Ltd. v. Midnight Storm Investments 386 Ltd.*[34] stands out. Here the court began the articulation of the basis for its decision by noting that the 2008 Companies Act clearly requires something less than that the debtor company's rehabilitation should be a reasonable probability. This, in the court's view, is an inference that must be drawn from the difference in language between the 1973 Companies Act which used the words "reasonable probability" in its s 417 and the 2008 Companies Act where the words used in section 131(4) are "reasonable prospect". In other words, the legislature must have intended to set the rehabilitation bar at a level lower than that prescribed under the 1973 Companies Act. The court was especially critical of the judicial approach to applications for "judicial management" when it stated that, "the mindset reflected in various cases dealing with judicial management

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31 *See* E.P. Joubert, *"Reasonable Possibility" versus "Reasonable Prospect": Did Business Rescue Succeed in Creating a Better Test than Judicial Management?,* 76 J. Contemp. Roman-Dutch L. 550, 562 (2013) (observing that, based on the recent case law, "the single most problematic factor that stands in the way of the granting of business rescue orders, is the uncertainty experienced by the courts regarding the meaning of 'reasonable prospect.'").

32 *See Swart v. Beagles Run Investments 25 (Pty) Ltd., (Four Creditors Intervening)* 2011 (5) SA 422 (S. Afr.); *AG Petzetakis International Holdings Ltd. v. Petzetakis Africa (Pty) Ltd. and Others* 2012 (5) SA 515 (S. Afr.); *Engen Petroleum Ltd. v. Multi Waste (Pty) Ltd. and Others* 2012 (5) SA 596 (S. Afr.); *Cape Point Vineyards (Pty) Ltd. v. Pinnacle Point Group Ltd. and Another, (Advantage Projects Managers) (Pty) Ltd. Intervening* 2011 (5) SA 600 (S. Afr.); *Essa and Another v. Bestvest and Another* 2012 (4) SA 103; *Investec Bank Ltd. v. Bruyns* 2011 (5) SA 430 (WCC) (S. Afr.); *Nedbank Ltd. v. Bestvest* 153 (Pty) Ltd. 2012 (5) SA 497 (S. Afr.); *Zoneska Investments (Pty) Ltd. t/a Bonatla Properties (Pty) Ltd. v. Midnight Storm Investments 386 Ltd.* 2012 (4) SA 590 (WCC) (S. Afr.).

33 Joubert, supra note 31, at 563.

34 *Southern Palace Investments (Pty) Ltd. v. Midnight Storm Investments (Pt) Ltd.* 2012 (2) SA 423 (WCC) (S. Afr.). The decision and reasoning in this case was followed in *Koen and Another v. Wedgewood Village Golf and Country Estate Ltd.* 2012 (2) SA 378 (WCC) (S. Afr.).

applications in respect of the recovery requirement was that, *prima facie*, the creditor was entitled to a liquidation order, and that only in exceptional circumstances would a judicial management order be granted."[35]

Having made the above points regarding the significance of the difference in the wording of sections 131(4) and 417, the court in *Southern Palace Investments* seems to have lost its course when it not only held that, in order to satisfy the lower threshold, the business rescue applicant must provide a business plan that:

Addresses the cause of the demise or failure of the debtor company's business and offers a remedy that has a reasonable prospect of being sustainable;

Provides concrete and objectively ascertainable details of:

The likely costs of making the company able to resume its business;

The likely availability of the necessary cash resources to enable the debtor company to meet its day-to-day expenses upon resumption of its operations;

The availability of any other resources; and

The reasons why the applicant suggests that the proposed business plan would have a reasonable prospect of success.[36]

Having indicated that the legislative intent behind the wording of section 131(4) was to set the bar lower than was the case in the "judicial management" era, the court in *Southern Palace Investments* ended up setting the bar even higher. But perhaps more troubling is the fact that the court's reasoning, with due respect, drifted into the realm of blatant error when it decided to impose, by implication, the duty to develop and present a sound and detailed rescue plan upon the applicant—for this is a duty that is expressly imposed on the business

[35] *See Southern Palace Investments,* 2012 (2) SA 423 at para. 21.

[36] *Id.*

rescue practitioner by the pertinent provisions of Chapter Six.[37] Furthermore, in terms of the minimum three months timeline that the Act allows for the practitioner to attempt successful rehabilitation of a financially distressed company, a careful reading of the pertinent provisions[38] would seem to suggest that the practitioner has a minimum of four weeks, subsequent to her appointment, within which to develop the rescue plan. But perhaps more worrisome is the fact that the courts in *Southern Palace Investments* and *Koen v. Wedgewood*[39] found that it was fair and realistic to require an applicant for business rescue to furnish a complete business rescue plan laden with the level of detail spelled out in their judgments as part of the minimum required to persuade a court to exercise its discretion in favour of an application for corporate rescue. This is because a careful reflection on the profile of stakeholders included in the definition of "affected persons" should suggest that such business rescue applicants would have neither the company-specific information nor the resources required to produce a competent rescue plan at the time of making the application under section 131 of the 2008 Companies Act. The view and attitude adopted by the courts in the above two cases smacks of judicial apathy towards business rescue applicants which does not bode well for the future of the Chapter Six rescue mechanism.

It is against the above background that the SCA's decision in *Oakdene Square Properties*[40] really does make a welcome entry into the corpus of the emerging South African business rescue jurisprudence.[41] In *Oakdene Square Properties*, the applicants for business rescue, having failed in the high court, argued before the SCA that the requirement of a "reasonable prospect" for rescuing the company in section 131(4) demands no more than a reasonable prospect of development and delivery of a rescue plan (by a business rescue practitioner). According

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[37] Companies Act 71 of 2008 § 140(1)(d)(i) (S. Afr.). It is both surprising and unfortunate that the decision in *Southern Palace Investments* was followed without reservation in *Koen and Another v. Wedgewood Village Golf and Country Estate Ltd.* 2012 (2) SA 378 (WCC) (S. Afr.).

[38] Companies Act 71 of 2008 at § 132. The court is conferred with discretion to allow a longer time on application made to it by the practitioner. *See* Companies Act 71 of 2008 § 132(3) (S. Afr.).

[39] CONTEMPORARY COMPANY LAW, *supra* note 7, at 861-64.

[40] *Oakdene Square Properties Ltd. and Others v. Farm Bothasfontein (Kyalami) Ltd. and Others* 2013 (4) SA 539 (S. Afr.).

[41] Joubert, *supra* note 31, at 562-63.

to them, an applicant for business rescue is therefore not required to show a reasonable prospect of achieving one of the two goals contemplated in section 128(1)(b). On this reasoning, all that the applicant is obliged to show is that "a plan to do so is capable of being developed and implemented regardless of whether or not it may fail."[42] Furthermore, according to the applicants' contention, once it is established that a business rescue applicant's intention is to develop and implement a plan whose purpose is the rescue of the debtor company, the court should grant the application even if it is skeptical regarding the potential of the applicant's plan to achieve the intended outcome.[43]

The SCA rejected the applicants' arguments *in toto*. It held that the words "rescuing the company"—as used in section 128(1)(b)—require the achievement of one of the alternative goals of business rescue. To that extent, the Court found that the argument advanced by the applicants "is in direct conflict with the express wording of s[ection] 128(1)(h)."[44] According to the SCA, on a careful reading of section 128(1)(b), it is evident that the development of a plan cannot be a goal in itself, but rather it can only be the means to an end which "must be either to restore the company to a solvent going concern, or at least to facilitate a better deal for creditors and shareholders than they would secure from a liquidation process."[45] Therefore, the evidentiary burden in the view of the SCA clearly lies on the business rescue applicant to establish grounds for the reasonable prospect of achieving one of the twin goals of section 128(1)(b).

Fraught with greater uncertainty, and therefore more worrisome, is the practical question as to how the business rescue applicant ought to discharge the said evidentiary burden. Should this applicant present the court with a detailed business rescue plan? Or should the applicant provide details of the likely costs enabling the company to recommence its business? Or should the applicant present

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[42] *Oakdene Square Properties Ltd. and Others v. Farm Bothasfontein (Kyalami) Ltd. and Others* 2013 (4) SA 539 at para. 31 (S. Afr.).

[43] *Id.*

[44] *Id.* It should be noted that while Companies Act 71 of 2008 § 128(1)(b) (S. Afr.) defines the term "business rescue," Companies Act 71 of 2008 § 128(1)(h) (S. Afr.) provides the definition of the term "rescuing the company."

[45] *Id.*

details pertaining to the likely availability of the cash resources required to enable the company to meet its day-to-day expenses? Or yet still, is the applicant required to provide concrete factual details of the source(s), nature, and extent of the resources that are likely to be available to the company as well as the terms on which such resources will be made available? In its decision on this practical question,[46] the SCA made it crystal clear that a business rescue applicant is not required to present a detailed rescue plan. However, an applicant must present "more than a mere prima facie case or an arguable possibility."[47] In this respect, mere speculative suggestions and vague averments will not suffice.[48] According to the SCA, what is required of an applicant is to establish the "reasonable grounds" on which she believes that there is a possibility of rescuing the company. Implicit in the court's decision here is that the applicant must provide a factual basis for the said grounds. Very significantly, however, the SCA held that it would be both impractical and imprudent to prescribe the manner in which business rescue applicants must meet this evidentiary burden in every case. Accordingly, to the extent that the courts in *Southern Palace Investments*[49] and *Koen v. Wedgewood*[50] sought to do so, they erred.

In setting the bar for the applicant regarding what is required to discharge the said evidentiary obligation, much judicial caution and circumspection is required. This is because if the bar is set too high, the practical effect will be devastating for the new business rescue regime and the achievement of policy goals it has been enacted to promote. Clearly, such a judicial approach will severely limit the availability of business rescue proceedings through section 131 of the 2008 Companies Act. It is noteworthy that this particular danger and the underlying concern has already been recognized by the high court

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[46] *Id.* ¶¶ 29-31. The SCA here approved and applied the approach adopted by the High Court in *Propspec Investments Ltd. v. Pacific Coast Investments 97 Ltd.* 2013 (4) SA 539 (S. Afr.).

[47] *Id.* ¶ 29.

[48] *Id. See also Propspec Investments Ltd. v. Pacific Coast Investments 97 Ltd.* 2013 (4) SA 539 at para. 11 (S. Afr.).

[49] *Southern Palace Investments (Pty) Ltd. v. Midnight Storm Investments (Pt) Ltd.,* 2012 (2) SA 423 (WCC) (S. Afr.).

[50] *Koen and Another v. Wedgewood Village Golf and Country Estate Ltd.* 2012 (2) SA 378 (WCC) at para. 14 (S. Afr.).

in *Propspec Investments Ltd.* and by the SCA in *Oakdene Square Properties* where it essentially endorsed the approach and related comments of van der Merwe J in *Propspec Investments Ltd.* The judges in both cases were of one mind in the view that the bar ought to be set fairly low for business rescue applicants, with a view favorable to maximizing the availability and use of business rescue proceedings. In this respect, the court in *Propspec Investments Ltd.*[51] and the SCA in *Oakdene Square Properties*[52] seem to both recognize that a contrary judicial approach would be effectively tantamount to judicial frustration of the real prospects of attaining the legislative and policy objectives behind the enactment of the Chapter Six provisions.[53]

The risk of business rescue becoming a victim of a judicial approach that is not predisposed to magnanimity towards those seeking to access the scheme is not far-fetched. This is because such a judicial attitude may be easily justifiable as an appropriate response to the real risk of abuse of business rescue proceedings by debtor companies and/or their controllers involved in a pattern of conduct clearly aimed at improperly defeating or delaying legitimate claims and rights of innocent creditors.[54]

In some cases, such patterns of behavior have been accompanied by evidence of misappropriation or abuse of company funds, assets, and/or opportunities by the controller(s) of the debtor company.[55] In such cases, business rescue proceedings are simply activated *mala fides* to allow the wrongdoing to continue for as long as

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[51] Bradstreet, *supra* note 10, at 353-56; Loubser, *Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law*, *supra* note 11, at 372.

[52] *Id.*

[53] In this respect it is pleasing to note the recent SCA decision in *Newcity Group (Pty) Ltd. v. Allan David Pellow NO and Others* 2014 ZASCA 162, where the court confirmed its approach and reasoning in *Oakdene Square Properties*.

[54] This risk of abuse by company directors, majority shareholders and other stakeholders has been recognized by other academic commentators. *See, e.g.*, Anneli Loubser, *The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions (Part 1)*, 3 J. SOUTH AFRICAN L 501, 505 (2010); DELPORT, *supra* note 7, at 446; Michael Steiner, *The Insolvency Bill 2000: Rescue Culture in the new Millennium*, 15 J. Int'l Banking L. 61, 62 (2000).

[55] *See*, *e.g.*, *Swart v. Beagles Run Investments 25 (Pty) Ltd., (Four Creditors Intervening)* 2011 (5) SA 422 (S. Afr.); *Oakdene Square Properties Ltd. and Others v. Farm Bothasfontein (Kyalami) Ltd. and Others* 2013 (4) SA 539 at para. 29 (S. Afr.).

possible to the maximum detriment of the company, creditors, shareholders and other stakeholders. Such undesirable behavior and tendencies on the part of directors and company controllers are readily apparent from the factual findings of the courts in the cases of *Oakdene Square Properties*,[56] *Newcity Group (Pty) Ltd. v. Allan David Pellow and Others*[57] and *Swart v. Beagles Run*.[58] Naturally, the public would expect the courts to be very vigilant in ensuring that the Chapter Six provisions are not invoked by company controllers or stakeholders acting *mala fides* for purposes that have little to do with achieving the underlying policy objectives but, instead, have all to do with wanting to co-opt business rescue proceedings into premeditated elaborate and illegal self-aggrandizing schemes capable of being perpetrated in the corporate context.

It is in their zeal to prevent the abuse of the Chapter Six provisions and related judicial processes that the courts may adopt principled positions leading to an unintended consequence, namely, a severe restriction of the availability of business rescue proceedings and frustration of the underlying legislative and policy intent. This could in turn lead to the business rescue model suffering the same fate as that which befell judicial management under the 1973 Companies Act. Against this background, the SCA decision in *Oakdene Square Properties* and the pronouncements on the applicable legal principles in *Propspec Investments Ltd.* must be applauded. Clearly, business rescue-related matters brought before the courts in the coming years will be guided by the pronouncements of legal principle made on this critical issue by the SCA in *Oakdene Square Properties*.

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56 In *Oakdene Square* Properties, there was evidence of management deadlock and related paralysis at the level of the board of directors resulting from the active conduct of the two director-shareholders who were the applicants for business rescue. In addition, the company had apparently been stripped of its sources of income through questionable dealings with its main assets, which were done by one of the said directors acting unilaterally without board approval but with the apparent tacit support and collusion of his co-applicant.

57 Companies Act 71 of 2008 § 131(4)(a) (S. Afr.).

58 Here, the facts accepted by the court showed that in the months immediately preceding the business rescue application, the company had been involved in a pattern of insolvent and fraudulent trading while under the control of the sole director-shareholder who was the stakeholder behind the application.

B. What Constitutes "Business Rescue" Under the Act

According to section 128, which is the opening definition section of Chapter Six, "business rescue" means "proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for"[59] among others:

> 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.[60]

In the academic discussions of this particular provision, there seems to be consensus that business rescue proceedings are intended by the legislature to have both a primary and a secondary objective—rehabilitating the company so that it is able to continue to operate as a solvent going concern being the primary goal, while rehabilitation for the very limited purpose of securing better returns for creditors and shareholders being secondary.[61] The suggestion implicit in the academic commentaries is that the proceedings must be initiated solely for the attainment of the said primary purpose; and may only turn to the pursuit of the secondary purpose after a realization *bona fides* in the course of implementing a properly adopted business rescue plan that the primary purpose is unattainable. This was one of the key issues that the SCA had to confront in *Oakdene Square Properties* where the court had to pronounce itself on whether a business rescue application under section 131 of the 2008 Companies Act could succeed where the proposed rescue plan only provides for the pursuit of the so-called secondary objective. In other words whether the requirement of "rescuing the company" as contemplated in section 131(4)(a) is satisfied where it is clear from the outset that there is no real chance

59 Companies Act 71 of 2008 § 128(1)(b) (S. Afr.).

60 *Id.* § 128(1)(b)(iii).

61 CONTEMPORARY COMPANY LAW, *supra* note 7, at 864-65; DELPORT, *supra* note 7, at 445-47.

of the company being saved from immediate liquidation and that the best the stakeholders can hope for is a better return to creditors and shareholders than that which would result from liquidation.[62]

Before the SCA, the respondents (who were creditors opposed to the business rescue application) relied on the dictionary meanings of the words "rescue" and "rehabilitate" to argue that the statutory definition of "business rescue" in section 128(1)(b) contemplates proceedings aimed at the rehabilitation of a company which in turn requires that the proceedings must be aimed at achieving the primary goal in section 128(1)(b)(iii), which is to restore the company to the normal healthy state of solvency.[63] In the respondents' view, the so-called secondary objective, to provide a better deal for creditors and shareholders than liquidation, can only be an alternative goal of the proposed business rescue plan. Accordingly, they submitted that a proposed plan, such as that in this case, that holds out no hope of a return of the company to a state of solvency, but provides at best for achievement of the secondary goal, does not amount to "rescuing the company" as required by the Act.[64]

The SCA held that Chapter Six of the Act, in section 128(1)(b) provides its own meaning for the terms "rescue" and "rehabilitate," neither of which coincide with the dictionary meanings of the words upon which the respondents sought to rely. In the SCA's view, "business rescue" under the Act means "to facilitate 'rehabilitation' which in turn means the achievement of one of two goals: (a) to return the company to solvency, or (b) to provide a better deal for creditors than what they would receive through liquidation."[65] Accordingly, the SCA concluded that the achievement of either one of the two goals

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[62] *Oakdene Square Properties Ltd. and Others v. Farm Bothasfontein (Kyalami) Ltd. and Others* 2013 (4) SA 539 at para. 23 (S. Afr.).

[63] In this respect, the respondents urged the court to endorse the approach followed by the High Court in the earlier case of *AG Petzetakis International Holdings Ltd. v. Petzetakis Africa (Pty) Ltd. and Others* 2012 (5) SA 515 (S. Afr.).

[64] *Oakdene Square Properties Ltd. and Others v. Farm Bothasfontein (Kyalami) Ltd. and Others* 2013 (4) SA 539 at para. 25 (S. Afr.).

[65] *Id.* ¶ 26.

referred to in section 128(1)(b) qualify as "business rescue" under the Chapter.[66]

The argument of the opposing creditors in *Oakdene Square Properties* invited the court to adopt a narrow construction of the meaning of "business rescue" under the 2008 Companies Act. If accepted, such an interpretation would effectively limit the availability of business rescue proceedings to those cases where there is at least a reasonable prospect of the company being restored to continuation as a going concern. Considering the policy goals and public interests behind the enactment of South Africa's business rescue scheme—especially those pertaining to employment preservation and creation as well as protection of vulnerable non-shareholder constituencies such as employees, customers, and communities—the restriction of the availability of business rescue only to those scenarios where there is at least some chance of saving the debtor company as a going concern would seem to be *prima facie* plausible. Indeed, it is arguable that the primary public interest rationale behind law and policymakers' decision to establish the business rescue model is to make it available for use by companies and stakeholders who find themselves with a financially distressed company that has a chance of being restored to its *status quo* prior to its financial woes.[67]

However, there are sound reasons why the SCA should be applauded for shunning a narrow interpretation of the meaning of "business rescue"—preferring instead to adopt a broad, generous construction that will ensure the availability of the rescue provisions

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[66] *Id.*

[67] The socio-economic policy goals and public interests at the heart of modern statute-based corporate rescue schemes can be readily gleaned from the pertinent primary and secondary sources, including the multiple reports issued or commissioned by relevant government departments. *See, e.g.*, CONTEMPORARY COMPANY LAW, *supra* note 7, at 861-64; CHAIRMAN SIR KENNETH CORK, INSOLVENCY LAW AND PRACTICE, REPORT OF THE REVIEW COMMITTEE, CMND 8558 (1982); SOUTH AFRICAN COMPANY LAW FOR THE 21ST CENTURY: GUIDELINES FOR CORPORATE LAW REFORM, GENERAL NOTICE 1183, *supra* note 4; Anneli Loubser, *Business Rescue in South Africa: A Procedure in Search of a Home*, 40 COMP. INT'L L. J. S. AFR. 152, 152-54 (2007); MCCORMACK, *supra* note 17, at 18-25.

even in those scenarios where liquidation is inevitable.[68] In the first place, creditors and shareholders, as company stakeholders, are not inherently undeserving of judicial sympathy and assistance when faced with a debtor that has no reasonable prospect of survival as a solvent going concern. Indeed, their role in the sustainable development of an enabling environment for companies and entrepreneurs to thrive cannot be overemphasized.[69] Limiting the availability of business rescue by excluding it from scenarios where there is only a likelihood of creditors and shareholders receiving better returns than on immediate liquidation would amount to adopting a statutory interpretation that is patently hostile to these two groups of stakeholders, both of whom are indispensable to the sustainable growth and survival of the modern company. This is so because the narrow definition for which the respondents argued in *Oakdene Square Properties* amounted to stating that business rescue ought not to be available where the primary beneficiaries will be creditors and shareholders. Clearly, such anti-creditor, anti-shareholder interpretation cannot be consistent with the underlying intention of the legislature.[70]

Furthermore, as the SCA itself pointed out,[71] a narrow interpretation seeking to limit the availability of business rescue to cases where there is a reasonable prospect of restoring the debtor

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68 *See* Richard Bradstreet, *Business Rescue Proves to be Creditor-Friendly: CJ Claasen's Analysis of the New Business Rescue Procedure in Oakdene Square Properties*, 130 SALJ 44, 49-52 (2013).

69 *See* Bradstreet, *supra* note 11, at 195.

70 It should be recalled here that Companies Act 71 of 2008 § 7(k) (S. Afr.) specifically states that one of the objects of the Act is to provide for the efficient rescue of financially distressed companies in a manner that balances the rights and interests of "relevant stakeholders." To the extent that creditors and shareholders are "relevant stakeholders," any interpretation of a provision of Companies Act 71 of 2008 Chapter Six that is hostile to their rights and interests without compelling justification, including being necessary for the protection of other relevant stakeholders' interests, would actually be inconsistent with the legislative intent encapsulated in the wording of Companies Act 71 of 2008 § 7(k) (S. Afr.). To the extent that the broad interpretation of the meaning of "business rescue" adopted by the SCA in *Oakdene Square Propert*ies is more consistent with the legislative prescription to balance the various stakeholder rights and interests, such an interpretation is highly plausible. *See* Bradstreet, *supra* note 68, at 49-52.

71 *Oakdene Square Properties Ltd. and Others v. Farm Bothasfontein (Kyalami) Ltd. and Others* 2013 (4) SA 539 at para. 26 (S. Afr.).

company to financial health as a going concern would be one that effectively ignores the historical context out of which the Chapter Six provisions originate. Central to that context is the "judicial management" model. The pertinent provisions of the 1973 Companies Act made the proper granting of a judicial management order conditional upon a finding of a *reasonable probability* that implementation of the order will result in the debtor regaining its ability to meet its financial obligations in the normal course of things. As indicated above, it is now widely acknowledged in both academic and judicial commentaries that it was the narrow restrictive meaning attributed by the judiciary to those key words that largely led to the abysmal failure of judicial management and its replacement with the business rescue model under the 2008 Companies Act. As the SCA concluded, it is unlikely that the legislature would have intended to repeat the mistakes of the past.[72]

C. Status of the Tax and Public Revenue Collection Authorities in Business Rescue Proceedings

The fascinating question of whether the South African Revenue Service ("SARS") enjoys special status in business rescue proceedings, as a preferent creditor, has come before the court in *Commissioner, South African Revenue Service v. Beginsel NO and Others*.[73] In this case, SARS contended that there was no reason why it could not have been specified as a preferent creditor in the proposed business rescue plan seeing that section 150(2)(b) of the 2008 Companies Act permits such a plan to create and specify the order of preference, in which proceeds of property sold pursuant to the plan will be applied subject to preferences conferred by the Act in section 135 upon different classes of post-commencement creditors.[74] The critical issue for determination was whether SARS ought to be treated as a preferent

72 *Id.* ¶¶ 27-28.

73 *Commissioner of South African Revenue Services v. Beginsel NO and Others* 2012 (1) SA 307 (WCC) at para. 20 (S. Afr.).

74 In requiring that every business rescue plan contain all information reasonably required to enable affected persons to decide whether or not to accept or reject a plan, Companies Act 71 of 2008 § 150(2)(b) (S. Afr.) prescribes a division of the plan into three parts: Part A providing a background; Part B setting out the debt and business restructuring proposals; and Part C setting out the assumptions and conditions on which the plan is based. See DELPORT, *supra* note 7, at 516-21.

creditor for purposes of reckoning its voting interest,[75] as well as for purposes of distributions of proceeds from disposals of company property by the business rescue practitioner. In advancing its case, SARS relied heavily on the provisions of sections 96 to 103 of the Insolvency Act No. 24 of 1936[76] ("Insolvency Act"), arguing that it is a preferent creditor whose claim ranks ahead of ordinary concurrent creditors. Based on section 103(1)(a) of the Insolvency Act, SARS further contended that because ordinary concurrent creditors are included in the class of concurrent creditors who would be subordinated in a liquidation referred to in section 145(4)(b) and because they would receive nothing on liquidation of the company in the instant matter, they (ordinary concurrent creditors) had no voting interest at the creditors' meeting.[77]

According to the court, the meaning and practical implication of the argument advanced by SARS is that while SARS, as preferent unsecured creditor, would have had a voting interest equal to the value of its claim against the company, the remainder of the (non-preferent) concurrent creditors representing eighty-seven percent of all creditors present at the particular meeting would have been disenfranchised concurrent creditors under section 145(4)(b). The obvious and inevitable result is that the vote of SARS alone would have ensured the rejection of the business rescue plan notwithstanding the wishes of the substantial majority of the creditors.[78] The court held that the construction of section 145(4) urged on it by SARS would lead to an illogical result that would fail to balance the rights and interests of all relevant stakeholders as envisaged in section 7(k) of the Act. In any event, according to the court, that interpretation is contrary to the ordinary grammatical meaning of the words used in the provisions of section 145(4). In the court's view, it is "wholly inconsistent with the

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[75] Creditors of a debtor company are conferred with voting interests in accordance with Companies Act 71 of 2008 § 128(1)(j) (S. Afr.) read together with Companies Act 71 of 2008 §§ 145(4) and (5) (S. Afr.). These provisions effectively fix a creditor's voting interest at the value of her claim against the company. Some academic commentators have taken the view that, at least for this purpose, it is immaterial whether a creditor's claim is secured or unsecured. *See* CONTEMPORARY COMPANY LAW, *supra* note 7, at 903.

[76] Insolvency Act No. 24 of 1936 (S. Afr.), as amended.

[77] *Commissioner of South African Revenue Services v. Beginsel NO and Others* 2012 (1) SA 307 (WCC) at para. 20 (S. Afr.).

[78] *Id.* ¶ 21.

purpose and scheme of the Act, to include all concurrent creditors under s[ection] 145(4)(b) of the Act, thereby almost certainly having their voting interests reduced and quite possibly entirely emasculated."[79] In this regard, the court agreed with the authors of Henochsberg[80] that such an interpretation of section 145(4) is grossly unfair to concurrent creditors, especially given that they have a greater level of interest in the debtor company's rescue than the secured creditors who can fall back on their security interest if the attempt at business rescue turned out to be a failure.[81]

The practical implications of judicial acceptance of the principle advanced by SARS would have been devastating, not only for non-preferent creditors generally, but also for the viability and attractiveness of business rescue proceedings in scenarios where the debtor company is substantially indebted to SARS. By adopting a legal position that is consistent with the principles of fairness and equality of creditors as against one that unduly places a particular creditor in a dominant position by enabling it to wield a casting or controlling vote (and thereby allowing it to predetermine the outcome of creditors' meetings), the court clearly signalled its discomfort with positions of legal principle that are certain to have the effect of undermining inclusive and egalitarian character of the rescue scheme that the legislature has established in Chapter Six of the Act. The court in *SARS v Beginsel* deserves to be applauded in this regard considering the fact that, under South Africa's tax and insolvency laws and related jurisprudence, granting preference to the claims or legal position of SARS is the norm rather than the exception. In this respect it would again have been easily defensible for the court to have aligned itself to the claim for preference by SARS ostensibly in defense of the public interest in maximizing legal protection of claims and monies owing to the national fiscus. It was therefore bold and courageous for the court to refuse preferential treatment for SARS in business rescue proceedings. The practical significance of this legal position is

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79 *Id.* ¶ 32.

80 DELPORT, *supra* note 7, at 509.

81 *See Commissioner of South African Revenue Services v. Beginsel NO and Others* 2012 (1) SA 307 (WCC) at para. 35 (S. Afr.); *See also* Okkie Blom & William Maodi, *Demoting SARS*, WITHOUT PREJUDICE (Sept. 2013), http://www.withoutprejudice.co.za/index.php/issues/item/demoting-sars?category_id=1.

enhanced by the likelihood that it will serve to discourage the granting of preference to other state-related claims that may be outstanding against debtor companies, such as monies due under municipal and environmental legislation.

D. Judicial Review and Setting Aside of Resolution of Board of Directors Commencing Business Rescue

As indicated above, the board of a financially distressed company may voluntarily place the entity under business rescue by adopting a resolution to that effect.[82] The Act provides recourse to unhappy stakeholders by stipulating that an "affected person" may apply to the court for an order setting aside the board's resolution on either one of three grounds:[83]

1. That there is no reasonable basis for believing that the company is financially distressed;

2. That there is no reasonable prospect for rescuing the company; or

3. That the company has failed to satisfy the procedural requirements set out in section 129 of the Act.

However, in adjudicating over an "affected person's" challenge against the board's resolution, the Act provides that the resolution may be set aside where, "having regard to all of the evidence, the court considers that it is otherwise just and equitable to do so." An interesting and important question that arose in the case of *DH Brothers Industries*[84] was whether the above provision constituted an additional (fourth) ground for invalidating the said resolution of the board on

82 It is required that the resolution be supported by a majority of the board. Accordingly, the absence of clear and credible evidence that the majority of directors were behind the resolution is fatal. See *DH Brothers Industries v. Gribnitz NO and Others 2014* (1) SA 103 at para. 16 (S. Afr.) (holding that adoption of the resolution by one of two directors constituted a failure to satisfy the procedural requirements of section 129—which is one of the bases on which the resolution may be set aside).

83 Companies Act 71 of 2008 § 130(1)(a) (S. Afr.).

84 *DH Brothers Industries v. Gribnitz NO and Others 2014* (1) SA 103 (S. Afr.).

which an "affected person" could rely.[85] What seems apparent from the text of sections 130(1)(a) and 130(5)(a) is that while the court is empowered to set aside the board resolution on four grounds, an "affected person" is only entitled to premise the application on one or more of the three grounds. According to the court in the *DH Brothers Industries* case, it would seem that "an application cannot be based on this fourth ground because the application then would not qualify as one brought in terms of section 130(1)(a)."[86] Given that section 130(5)(a) essentially empowers the court to grant relief on a cause of action which cannot, on its face, be relied upon by an applicant seeking to set aside the board resolution in question, the court concluded that the said provision creates an anomaly. Taking the view that "the distinction between s 130(1)(a) and s 130(5)(a) clearly arises from a drafting error," the court in *DH Brothers Industries* held that, "the only sensible meaning which avoids the absurdity which would otherwise result is to construe the just-and-equitable basis as an additional ground to the three listed in s 130(1)(a)."[87] The result is that it can be relied upon as a fourth ground or cause of action by an "affected person" seeking relief under section 130(1)(a).[88]

Section 130(5)(a) specifically requires a court to consider all of the evidence before reaching a decision on the just and equitable ground. In the *DH Brothers Industries* case, the court held that the following were factors that must be considered:

- Whether the business rescue plan was properly adopted; and
- The terms of the plan and, in particular, whether it contains any offensive provision.[89]

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[85] This issue was addressed by the court in *DH Brothers Industries*, 2014 (1) SA 103, because the applicant-creditor specifically relied on the "just and equitable provision" of Companies Act 71 of 2008 § 130(5)(a)(ii) (S. Afr.).

[86] *Id.*

[87] *Id.* ¶ 18.

[88] *Id.*

[89] *Id.* ¶ 19. It is submitted that there are at least two additional factors that courts should in this context recognize as relevant, namely: (a) whether there are any real prospects of a successful rescue given the debtor-company's circumstances; and (b) whether there is any evidence of the directors acting *mala fides*.

The manner in which the court in *DH Brothers Industries* resolved the anomaly and potential conflict created by the provisions of sections 130(1)(a) and 130(5)(a) is jurisprudentially significant in more ways than one. First, the court's decision effectively enlarged the provisions of section 130(1)(a) by explicitly making available a fourth additional ground that may be invoked by company stakeholders seeking to prevent a financially distressed company from being voluntarily placed under business rescue by its directors. Second, given the omnibus, open-ended (catch-all), and amorphous nature of the just-and-equitable ground, the decision in *DH Brothers Industries* significantly strengthens the hands of creditors who comprise the stakeholder group more likely to be opposed to business rescue while similarly weakening the prospects of such a board resolution surviving judicial scrutiny. It is submitted that, at least on the face of it, this decision is not supportive of the institution of business rescue.

E. Legality of Contents of Plan: Appropriateness and Validity of a Provision Effecting Compulsory Cession of Part of Creditors' Claims

In the *DH Brothers Industries* case, part of the fact complex was that the opposing creditor who sought an order setting aside the board's resolution placing the debtor company under business rescue was owed a debt of approximately R 5,000,000, which was secured by deeds of suretyship provided by the company's two directors (who were also the only shareholders). The plan put forward by the business rescue practitioner provided for the creditor to (a) receive 12.25% of the face value of its claim as a dividend; and (b) cede (transfer) 75.75% of its claim to a share trust established for the exclusive benefit of the company. The applicant creditor contended that, to the extent that the plan provided for a compulsory cession of a substantial part of its claim, it was not the kind of plan envisaged under the Act, especially given that the applicant would be rendered unable to recover the ceded portion of its claim from the directors who acted as sureties for the company.[90]

It is noteworthy that none of the provisions of the now famous Chapter Six speaks to the effect, if any, of business rescue proceedings

[90] *Id.* ¶ 64.

on the liability of persons who had in the period preceding the commencement of the proceedings furnished deeds of suretyship on the debtor company's behalf.[91] Interestingly, section 155(9) of the Act, which is located in the same Chapter Six, specifically provides that the adoption of a scheme of arrangement or compromise has no effect on the liability of a person who is a surety of the company.[92] In this respect, the applicant submitted that, given that all creditors are bound by an adopted plan irrespective of whether or not they voted in favor, the legislature would have included a provision similar to section 155(9) if it had been within its contemplation that compulsory cessions of creditors' claims could properly form part of a business rescue plan.

With respect to compulsory partial or total forfeiture of creditors claims and/or related rights, the court in *DH Brothers Industries* noted that Chapter Six of the 2008 Companies Act only provided for (a) partial deprivation or forfeiture on the part of creditors who consented to the discharge of their debt in whole or in part[93] and (b) enforcement of pre-business rescue debts to the limited extent permitted by the terms of an adopted rescue plan.[94] Against the background of these two provisions, the court held that "any provision in a plan which goes beyond a voluntary discharge of the whole or part of a debt is not competent."[95] After noting that the plan in this case went far beyond what was permitted by the pertinent provisions of sections 152 and 154 and emphasizing the well-established presumption in South African law against any deprivation of rights by legislation, the court concluded that "it must follow as night follows

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91 Interestingly, Companies Act 71 of 2008 § 155(9) (S. Afr.), which section is located in the same Companies Act 71 of 2008 Chapter Six (S. Afr.), specifically provides that the adoption of a scheme of arrangement or compromise has no effect on the liability of a person who is a surety of the company.

92 Companies Act 71 of 2008 Chapter Six (S. Afr.) consists of twenty-eight sections laid out in five parts (A-E). It is interesting to note that only part E, consisting of only one section, deals with the subject of "compromise between company and creditors."

93 *See id.* § 152(4).

94 *Id.* § 154(2).

95 *DH Brothers Industries v. Gribnitz NO and Others 2014* (1) SA 103 at para. 67 (S. Afr.).

day that a plan which deprives non-acceding creditors of the right to enforce a claim against a surety does not pass muster."[96]

Most interestingly, this is one issue on which the court in *DH Brothers Industries* agreed with the reasoning and conclusions of the court in the earlier case of *African Banking Corporation of Botswana Ltd. v. Kariba Furniture Manufacturers (Pty) Ltd*.[97] In the latter case, the applicant creditor bank maintained that the fact that the board of the debtor company resolved to place it under business rescue could not deprive it of its right to pursue the directors as sureties pursuant to the suretyships they provided in the period preceding commencement of business rescue. However, the practitioner took a different view, similar to that of the shareholders who happened to be the same directors and sureties in question. Accordingly, the bank sought a declaratory order that the adoption of a business rescue plan, with respect to a company placed under business rescue, would not affect the rights a creditor has under suretyships executed with respect to amounts owed by the company under business rescue. The court held that there was no express provision in Chapter Six providing that the adoption of a business rescue plan will deprive creditors of the company of their rights as against sureties for the company's debts.[98] The court concluded that there need be no connection between a surety and either the company in financial distress or the stakeholders, and that whether or not a creditor is entitled to pursue a surety will, in the ordinary course, have no bearing on the prospects of rescuing the company. Thus, in the court's view, the interests of sureties do not fall within the scope of the objectives of the business rescue regime. In this regard, it relied on the sentiments of Rogers AJ in *Investec Bank Ltd. v. Bryuns*,[99] where the court decided that section 133 (2) explicitly referred to the stay of suretyship undertaken by the company and not a suretyship undertaken by a third person for the indebtedness of the

[96] *Id.* ¶ 67.

[97] *African Banking Corp. of Botswana Ltd. v. Kariba Furniture Manufacturers (Pty) Ltd. and Others* 2013 (6) SA 471 (S. Afr.).

[98] *Id.* ¶¶ 68-69. The court also opined that: "If the legislature intended that the adoption of a business rescue plan would have such a far-reaching consequence, the legislature would have expressly provided for this consequence . . . . There is, furthermore, no basis to suggest that such a provision could be read into the business rescue regime."

[99] *Investec Bank Ltd v. Bruyns* 2012 (5) SA 430 (WCC) (S. Afr.).

company. Accordingly, the court in *African Banking Corporation* held that the adoption of the plan would not affect the opposing creditor bank's claim against the debtor company's directors as sureties for the debts of the company.

The overwhelmingly pro-creditor position and perspective adopted by the courts in the three cases mentioned above are both plausible and justifiable on a number of grounds. First, it prevents abuse and opportunism in the context of business rescue proceedings. This is because, as observed by the court in *African Banking Corporation*, there is no functional link between the policy goal of ensuring success for the process of rescuing a financially distressed company and the continuation or cessation of the liability assumed by persons who provided suretyships in support of the company's pre-business rescue debts. Allowing such sureties to essentially "free-ride" on the business rescue proceedings to abandon their contractual obligations (as was attempted by the two directors in *DH Brothers Industries*) smacks of opportunism and unjust enrichment, which is the kind of conduct or behavior that the courts are expected and indeed duty bound to discourage.[100] Second, it is required of the courts to strive to maintain a careful balance between the relevant stakeholders' interests in the business rescue context.[101] The development of jurisprudence that is accepting of business rescue plan provisions aimed at advantaging sureties by terminating their obligations under the suretyships merely because the debtor company has been successfully placed under business rescue inappropriately skews that balance against company creditors and their interests. This is especially problematic given that the impugned terms of the rescue plans in *DH Brothers Industries* and *African Banking Corporation* sought to effectively negate existing contractual rights of company creditors and actually did so in a manner that was akin to "expropriation" of property rights without compensation. Such jurisprudence does not belong in the corpus of contemporary South African company law. Third, permitting terms in

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[100] Not surprisingly, the court in *DH Brothers Industries* found the provisions of the business rescue plan aimed at the compulsory, non-consensual nullification of the two shareholder-directors' obligations under suretyships held by a number of the creditors to be both offensive and constitute a basis on which it could be properly concluded that it was "just and equitable" to set aside the proceedings. *See DH Brothers Industries v. Gribnitz NO and Others 2014* (1) SA 103 at para. 68 (S. Afr.).

[101] Companies Act 71 of 2008 § 7(k) (S. Afr.).

business rescue plans that seek to, *inter alia*, terminate suretyship obligations could undermine the integrity and credibility of the entire corporate rescue regime by creating space and incentives for collusion between business rescue practitioners and sureties aimed at improperly benefiting the latter.

CONCLUSION

Prima facie, the fact that there have been significantly more adverse judicial decisions on business rescue applications than those in favor may be troubling for law and policy makers and their supporters desperate to see the firm establishment of South Africa's corporate rescue model as well as the rapid entrenchment of a similarly supportive judicial culture. Obviously, such a culture would be one that is hostile to the idea of liquidating companies that have the slightest prospects of rehabilitation, especially where, as in *DH Brothers Industries*, there is no evidence of fraud or bad faith on the part of either the business rescue practitioner or the "affected persons" supporting the business rescue plan.[102] Shareholders, employees, trade unions, and the Companies and Intellectual Property Commission are certain to be among those stakeholders already getting concerned about the very poor success rate of business rescue applications thus far.

This apparently poor start to the tenure of Chapter Six can be considered problematic from another perspective, namely, that it may lead to the proliferation of a perception among stakeholders that the courts are generally not supportive of, or favorably disposed toward, business rescue applications. This perception may in turn create a chilling effect through the under-utilization of the mechanism due to the emergence of widespread belief that applications for business rescue proceedings by "affected persons" are not worth the inevitable investment of time and resources because of their limited prospects of success. Perhaps more importantly, the resulting decline in enthusiasm and support for the business rescue mechanism could significantly

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[102] In this respect the unmistakeable pro-rescue disposition of the courts in India is of great interest and, from a South African perspective, probably worth emulating. *See* Kristin Van Zwieten, *Corporate Rescue in India: The Influence of the Courts*, 1 J. CORP. L. STUD. (Forthcoming 2015).

undermine the prospects of Chapter Six achieving the socio-economic public policy goals intended for it by the legislature.

However, it is arguable that, notwithstanding the fact that the courts' decisions on business rescue applications have been generally negative, the rulings and interpretive positions they have taken on most of the pivotal questions and issues can be said to be business rescue-friendly and therefore supportive of the future development of the mechanism. In this respect, the decisions and reasoning in the cases of *Oakdene Square Properties*, *Beginsel NO v. SARS*, and *African Banking Corporation* should be applauded in the hope that courts will enthusiastically follow them in future cases.

Finally, judgments are also beginning to clearly show that there are significant gaps in the framework and provisions of Chapter Six in terms of both the omission to make express provisions on what are important and foreseeable business rescue-related issues and the poor drafting quality of those provisions.[103] The result is that in the coming years South Africa is likely to see sharply contrasting judicial decisions as already appears from cases dealing with the question of "reasonable prospect of rescue." Accordingly, for the early years of the regime's implementation, company stakeholders, business rescue practitioners, and their legal advisers will have to contend with a significant degree of uncertainty in this area of contemporary South African company law.[104]

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[103] This has come out most starkly in the context of the litigation around the "binding offer" provisions of Companies Act 71 of 2008 § 153(1)(b) (S. Afr.) in the two cases of *African Banking Corp. of Botswana Ltd. v. Kariba Furniture Manufacturers (Pty) Ltd. and Others*, 2013 (6) SA 471 (S. Afr.) and *DH Brothers Industries v. Gribnitz NO and Others 2014* (1) SA 103 (S.Afr.). In the latter case, Gorven, J. lamented the drafting-related weaknesses of the Chapter Six provisions in no less than two paragraphs of his judgment.

[104] See DELPORT, *supra* note 7, at 5 (predicting, two years before the 2008 Companies Act came into operation, that it will pose multiple problems that are likely to "cause uncertainty in its application"); Anneli Loubser, *The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions (Part 2)*, 4 J. SOUTH AFRICAN L. 689, 701 (2010) (calling for legislative intervention by way of amendment of the pertinent provisions as a matter of urgency because of "the many unclear, confusing and sometimes alarming provisions.").