



**A LIBERAL INTERPRETATION OF SECTION 131 OF THE  
COMPANIES ACT 71 OF 2008 IN LIGHT OF RICHTER V ABSA**

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THIS RESEARCH PROJECT IS SUBMITTED IN PARTIAL FULFILMENT OF THE  
REGULATIONS FOR THE DEGREE OF MASTERS OF BUSINESS LAW IN THE  
COLLEGE OF LAW AND MANAGEMENT STUDIES UNIVERSITY OF KWAZULU-  
NATAL.

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## **ACKNOWLEDGEMENTS**

I would like to acknowledge my family for their continuous support, especially my parents Pranesh Indrajith and Anita Indrajith.

Dad, I have acknowledged your work as a lawyer and have cited one of your reported cases in this study, but it is your work as a father that makes me most proud. Thank you for all your support and guidance.

Mom, thank you for all the emotional support and always protecting me. Everything I achieve is because of you.

I am also grateful to my supervisor, Adv. Darren Subramanien, thank you for dedicating your time and effort to guide this study in the right direction.

## **ABSTRACT**

Business rescue is a corporate rescue system in South African law that has replaced judicial management. An applicant in a business rescue application in terms of section 131 of the Companies Act 71 of 2008 has to satisfy the court that there is a 'reasonable prospect of success.' This term has existed in South African law before the enactment of the Companies Act 71 of 2008 but judicial attention in giving effect to this term has been centered around judicial managements failure. This study recognizes that judicial management is a failure and proposes a new approach that is completely divested from judicial management. The first part of the study examines the way in which the judiciary has approached interpreting 'reasonable prospects' by critically analyzing the sources the courts have used and conclusions reached. The study breaks down the judiciaries attitude and approaches to 3 different cases which are classified as first, second and third generation cases. The study argues that if business rescue is to be successful then the Companies Act 71 of 2008 should be amended or a new fourth generation of cases need to adopt a liberal approach to 'reasonable prospects' by considering the previous jurisprudence on this term as well as relying on the procedural safeguards in Companies Act 71 of 2008.

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## CHAPTER 1: INTRODUCTION

### 1.1 BACKGROUND OF STUDY

The role of company law is to provide a stable platform for economic activity to take place.<sup>1</sup> A part of this includes providing safeguards against commercial death such as compromises with creditors and rescue regimes.<sup>2</sup> The rationale for these corporate rescue regimes is aimed at allowing a company to continue to exist and maintain its role in the corporate ecosystem. The system of rescuing or reorganizing an ailing entity operates as a lifeline that provides a hibernation from creditors enforcing their claims.<sup>3</sup> While the creditors rights to claim are limited the company continues to operate as opposed to the immediate liquidation which has the potential to cause an imbalance and knock on effect to stakeholders of the company. The ultimate goal of business rescue systems is restoring an entity to solvency so that it may continue to trade in the market place.<sup>4</sup>

South Africa's rescue procedure is codified in Chapter 6 of the Companies Act 71 of 2008 (hereinafter 'the Companies Act 2008') which has been created to replace the old system of judicial management. A variety of stakeholders from academics to owners of companies have eagerly awaited and welcomed this change in our law. This is due to the failure of the judicial management system which was seen as expensive, out dated and counterproductive. Corporate rescue mechanisms are aimed at preventing liquidations and it often was the case that judicial management was simply a stepping stone to liquidation.<sup>5</sup>

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<sup>1</sup> South African Dept. of Trade and Industry *Policy Paper: Company Law for the 21<sup>st</sup> Century Guidelines for Corporate law reform*. GN 1183 in GG 26493 of 23 June 2004.

<sup>2</sup> Companies Act 71 of 2008: s7.

<sup>3</sup> Companies Act 71 of 2008: s133.

<sup>4</sup> Companies Act 71 of 2008: s128(b)(iii).

<sup>5</sup> R, Bradstreet 'Business Rescue Proves to Be Creditor-Friendly: CJ Claassens J's Analysis of the New Business Rescue Procedure in Oakdene, Square Properties' (2013) 130 *South African Law Journal* 44-52.

The buildup to the enactment of chapter 6 of the Companies Act 2008 was no small feat and there had been plenty of time from the introduction of judicial management in 1926 to 2011 for the legislature to create a workable and pragmatic approach to corporate rescue in South Africa.<sup>6</sup> The legislature considered various laws in an attempt to be on par with leading foreign jurisdictions such as America, Australia and England.<sup>7</sup> On the 1<sup>st</sup> of May 2011 business rescue was born into our legislation and with it came a new heap of problems. Some of these problems were foreseeable and others could have been foreseeable due to the repeating of certain elements of judicial management and by examining comparative jurisdictions mechanisms.

One of the shortcomings of judicial management was that it placed too high a burden on an applicant to discharge. This has subsequently been changed for business rescue.<sup>8</sup> An applicant under judicial management would have to prove to the court that there exists a reasonable probability that the company can be rescued, compared to the lower threshold of reasonable prospects in business rescue applications.<sup>9</sup> However, as I have alluded to previously that some of the mistakes of judicial management have been repeated, one of these, is the lack of a comprehensive definition of the recovery requirement.<sup>10</sup> The legislature's failure to define what reasonable prospects are, have led to the courts inheriting this duty. This study involves analyzing the way in which the courts have applied this duty.

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<sup>6</sup> Companies Act 46 of 1926.

<sup>7</sup> South African Dept. of Trade and Industry *Policy Paper: Company Law for the 21<sup>st</sup> Century Guidelines for Corporate law reform*. GN 1183 in GG 26493 of 23 June 2004.

<sup>8</sup> Companies Act 61 of 1973: s427.

<sup>9</sup> Companies Act 71 of 2008: s131.

<sup>10</sup> *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm 386 (Pty) Ltd* 2012 (2) SA 423 (WCC).

## 1.2 PURPOSE AND SIGNIFICANCE OF THE STUDY

The purpose of the study is to critically analyze the court's discretion when deciding business rescue applications when a company is in liquidation. The study is significant because it evaluates whether courts should adopt a liberal approach towards deciding whether there are reasonable prospects of a company being rescued or follow a strict inflexible approach. The ultimate aim is to decipher what the courts require of an applicant to prove a company has reasonable prospects while in liquidation and whether this approach is correct.

## 1.3 METHODOLOGY

This thesis adopts the comparative method of research to critically analyze judicial interpretation and attention when adjudicating over business rescue applications. Particular emphasis will be placed on reasonable prospects after a final order of liquidation has been granted and what role judicial interpretation has played in adding substance to the framework established in chapter 6 of the Companies Act 2008. The research has adopted a doctrinal approach through locating and analysing relevant legislation, academic writing and case law with particular emphasis on the *Richter v ABSA* case.<sup>11</sup> This case deals with a successful business rescue application brought 6 months after a final order of liquidation had been granted.<sup>12</sup> One of the points in opposition was that if the court were to adopt such a liberal approach to business rescue applications it would lead to various avenues which allowed persons to abuse this mechanism.<sup>13</sup> Although the court had made a finding on this point I intend to examine this issue by considering the effects and consequences of the court adopting

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<sup>11</sup> *Richter v ABSA Bank Limited* (20181/2014) [2015] ZASCA 100.

<sup>12</sup> *Richter* supra note 11 at 2.

<sup>13</sup> *Richter* supra note 11 at 16.

a liberal interpretation and approach. A part of this study will be based on determining whether the reasonable prospect test is objective or subjective and whether it applies in the same way to all companies and at all times during financial distress.<sup>14</sup>

I will defend the view that the Companies Act 2008 supports a liberal interpretation and that there exists no absolute bar on business rescue applications being granted after a lengthy period has lapsed. Whilst courts must treat business rescue applications after a final order with caution, there exists no rubicon that prevents an applicant from applying before the Master of the High Court issues a certificate in the Government Gazette that the company has been dissolved. This study involves comparing the external effects of a court adopting a liberal interpretation by comparing the effect on third parties such as creditors and liquidators and weighing up the competing interests against the objectives of business rescue to determine whether a liberal interpretation is feasible. I will defend the view that the new business rescue regime has changed the corporate landscape which was creditor friendly and is now debtor friendly whilst maintaining that this does not necessarily mean it is creditor unfriendly.<sup>15</sup>

#### **1.4 LITERATURE REVIEW**

Business rescue has been termed a new baby in our law which implies that it needs to grow and develop.<sup>16</sup> This has led to various writers and critics offering a variety of perspectives on its operations and effects. The new regime is much broader than

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<sup>14</sup> EP, Joubert 'Reasonable possibility versus reasonable prospects: Did business rescue succeed in creating a better test than judicial management?' (2013) 76 *Journal of Contemporary -Dutch law* 550-563.

<sup>15</sup> Bradstreet op cit note 5 at 44-53.

<sup>16</sup> *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd and Another* (13/12409) [2013] ZAGPHC 109.

judicial management and refers to an affected person being able to approach the court to seek an order for compulsory business rescue. The persons which fall under this category of affected person are employees, directors and trade unions who are just a few that are vested with *locus standi* in a business rescue application. This has led to many writers focusing on the interests of a particular group, for example Bradstreet and Loubser are notable academics in this area of law and have published works, examining the role and effects on shareholders during business rescue. Bradstreet argues that business rescue should be attractive to creditors of large companies in financial distress more so than smaller companies given the costs associated with business rescue. Loubser argues that business rescue offers protection of employees but the definition of business rescue fails to make one of the objectives of the regime to preserve jobs<sup>17</sup>

#### *1.4.1 SOCIAL CONSEQUENCES AND EMPLOYMENT PERSPECTIVE*

The social consequences and employment perspective has also been widely written on and writers have contributed in determining where each affected persons fit in, what role they play in business rescue and how their rights are affected when a company is in business rescue.<sup>18</sup> The comparison between judicial management and business rescue has sparked debate ever since the proposal of a new rescue mechanism was tabled and many writers have offered valuable historic perspectives that grasps the way in which South African law has changed from 1926 to 2011.<sup>19</sup>

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<sup>17</sup> R, Bradstreet 'The New Business Rescue: Will Creditors Sink or Swim' (2011) 128 *SALJ* 352-380 and A, Loubser 'The Role of Shareholders during Corporate Rescue Proceedings: Always on the outside Looking in (2008) 20 *SA MERC* 372-390.

<sup>18</sup> A, Loubser 'The role of trade unions and employees in South Africa's business rescue proceedings (2015) 36 *ILJ* 21-39.

<sup>19</sup> Joubert op cite note 14.

It is accepted that where a company is placed under a business rescue the statutory moratorium automatically comes into place for the company only.<sup>20</sup> This has provided clarity in cases where a surety unsuccessfully attempted to argue that a moratorium also applied to sureties of a company under business rescue where a creditor sort to enforce their claim.<sup>21</sup> Therefore the perspective of sureties has also been well documented on in case law and I will not be examining this aspect.<sup>22</sup>

The operation of the moratorium and its limitation of a creditor's rights to enforce their claim against the company has also been decided in case law. The legislature has established a clear procedure where a creditor seeks leave from the court to institute legal proceedings against a company, and in certain situations a separate application need not be made.<sup>23</sup> This means that the issue of leave to proceed can be dealt with as a point in *limine* together with the legal proceedings.<sup>24</sup> The courts have also been tasked with determining whether leave to proceed can be granted retrospectively and there have been conflicting judgements in this regard.<sup>25</sup> There are certain areas that have unanswered questions of what exactly constitutes legal proceedings but I do not intend to analyze this area.<sup>26</sup>

#### 1.4.2 THE ROLE OF THE BUSINESS RESCUE PRACTITIONER

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<sup>20</sup> Companies Act 71 of 2008: s133.

<sup>21</sup> *Investec Bank Ltd v Bruyns 2012 (5) SA 430 (WCC) and First Rand Bank Ltd t/a RMB Private Bank v Nagel (2013) ZAGPJHC 200.*

<sup>22</sup> *Newport Finance Company (Pty) Ltd t/a Balanced Audio v Greef and Another 2014 (4) SA 521 (WCC).*

<sup>23</sup> *Resource Washing (Pty) Ltd v Zululand Coal Reclaimers Proprietary Limited and Others (10862/14) [2015] ZAKZNPHC 21.*

<sup>24</sup> *Booyesen v Jonkheer Boerewynmakery (Pty) Ltd and Another 2017 (4) SA 51 (WCC)-*

<sup>25</sup> *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd and Another (13/12409) [2013] ZAGPHC 109 (10 May 2013), Redpath Mining South Africa (Pty) Ltd v Marsden N.O. & Others [2013] ZAGPJHC 148.*

<sup>26</sup> *Chetty t/a Nationwide Electrical v Hart and Another 2015 (6) SA 424 (SCA). And National Union of Metalworkers of SA obo Members v Motho Steel Engineering CC [2014] JOL 32257 (LC).*

The perspective of business rescue practitioners and the duties placed upon them have also been discussed. This area has led to writers criticizing the lack of regulations governing business rescue practitioners and how this may hamper the objectives of business rescue.<sup>27</sup> Courts have already decided that business rescue practitioners owe a fiduciary duty towards the company and their actions must be aimed at the best interests of the company or they can be removed.<sup>28</sup> The ways in which a director and business rescue practitioner abused the system was adequately dealt with in *Griessell and Another v Lizemore and Others*<sup>29</sup> Where a business rescue practitioner fails to comply with the procedures set out in the Companies Act 2008 with regards to notice to creditors and failing to adopt a business rescue plan have already been decided.<sup>30</sup>

#### 1.4.3 ABUSE OF PROCESS

The idea of corporate rescue is not a new one and one will struggle to find a jurisdiction without a rescue regime and this had led to many comparative contributions that examine South Africa's systems against a foreign system.<sup>31</sup> Many cases have dealt with the issue of business rescue with parties arguing that business rescue applications are an abuse of process.<sup>32</sup> These arguments are often seen in cases where a provisional order of liquidation has already been granted and on the return date the company files a business rescue application and the liquidation application is suspended.<sup>33</sup> Where there is a winding up application and a subsequent business

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<sup>27</sup> R, Bradstreet 'The Leak in Chapter 6 Lifeboat: Inadequate Regulation of Business Rescue Practitioners May Adversely Affect Lenders Willingness and the Growth of the Economy' (2010) 22 *SA MERC* 195-213.

<sup>28</sup> 2016 (6) SA 236 (GJ).

<sup>29</sup> *Lizemore* supra note 28.

<sup>30</sup> Z, Buba "Possible consequences of the failure of an adopted business rescue plan" (2017) *De Rebus* 20 and *Lizemore* supra note 28.

<sup>31</sup> H, Stroop and A, Hutchison 'Post commencement Finance – Domiciled Resident or Uneasy Foreign Transplant' (2017) 20 *PER* 1-41.

<sup>32</sup> *Gormley v West City Precinct Properties (Pty) Ltd and Another v West City Precinct Properties (Pty) Ltd and Another* (19075/11,15584/11) [2012] ZAWCHC 33.

<sup>33</sup> *Standard Bank of South Africa Limited v Gas 2 liquids (Pty) Limited* 2017 (2) SA 56 (GJ).

rescue application they are usually consolidated and heard together as a court is empowered to dismiss the business rescue application and order the company be wound up.<sup>34</sup> These types of practical examples have already been decided and the legislature and courts agree that business rescue is preferred over liquidation if it is applicable.<sup>35</sup> While it is accepted that business rescue proceedings suspend liquidation proceedings, there have been conflicting judgments on its practical application. The courts have had to decide what liquidation proceedings are, when they begin and when a business rescue application is made.<sup>36</sup> These two issues have already been decided and that is why I intend to conduct my research on business rescue after a company is in liquidation.

## **1.5 FOCUS OF THE STUDY AND PRIMARY RESEARCH AREA**

The study has been narrowed down to cater for a very specific instance given the vast array of areas that have already been covered in existing literature. Business rescue might be a new concept, but it has been heavily written about. This study breaks down the different stages of business rescue to focus only on instances where a company is in liquidation and then seeks to apply for business rescue. The existing literature often looks at a specific requirement in section 131 of the Companies Act 2008 such as financial distress or a specific perspective of an affected person such as a creditor. This study differs as it looks at the recovery requirement only in the context of a company that has begun being wound up. This study analyses the consequences that occur when a company in liquidation is placed in business rescue and uses this

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<sup>34</sup> *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa and Another v Bestvest (Pty) Ltd and Others* 2012 (5) SA 497 (WCC).

<sup>35</sup> *Blue Star Holdings (Pty) Ltd v West Coast Oyster Growers CC* 2013 (6) SA 540 (WCC).

<sup>36</sup> *Engen Petroleum Ltd v Multi Waste (Pty) Ltd and Others* 2013 (5) SA 596 (GSJ), *Absa Bank Limited v Summer lodge (Pty) Ltd* [2013] ZAGPPHC, *Taboo Trading 232 (Pty) Ltd v Pro Wreck Scrap Metal cc and Others* 2013 (6) SA 141 KZNP.

research as a factor to determine whether the courts should adopt a liberal interpretation of the term reasonable prospect.

## **1.6 OVERVIEW OF CHAPTERS**

This study consists of four content parts with the first and second parts being the theoretical and historic aspect which introduces the applicable laws that apply to business rescue and how it has been developed. The third part will consist of analyzing existing cases and articles and lastly the conclusion will take the form of establishing a set of triggers and factors that should be used as a guideline when determining a business rescue application for a company in liquidation.

The first content chapter will introduce the framework governing business rescue and an interpretation of their meaning by the courts. This chapter distinguishes between first, second and third generation business rescue cases. Much of this chapter will focus on the proper meaning of reasonable prospects and what sources courts have used when interpreting its meaning. The last part of this chapter will be an overview of the *Richter v ABSA* judgment as all chapters will refer to parts of this case.<sup>37</sup>

The second chapter will focus on what are reasonable prospects for a company in liquidation. This chapter will consider the usefulness of other sources that deal with the term 'reasonable prospects' and will refer back to appellate division cases and appeal cases that have also analyzed this term.

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<sup>37</sup> *Richter* supra note 11.

The consequences of adopting a liberal approach will be dealt with in the third content chapter. This chapter will look at what happens to a liquidator during business rescue and how claims are ranked? The third chapter will also examine who is in control of a company in liquidation that has filed an application for business rescue suspending the liquidation, but that application has not yet been heard or decided. The last part of this chapter will look at whether subsequent business rescue applications can be brought and whether the failure of the board of directors to voluntarily adopt a resolution to commence business rescue should be used as a factor against granting a court order to commence business rescue.

The concluding chapter will make recommendations as to why the Companies Act 2008 should be amended to allow for a guiding provision that will direct the courts in establishing a clear and coherent standard for reasonable prospects.

## CHAPTER 2: FRAMEWORK OF BUSINESS RESCUE

### 2.1 THE COMPANIES ACT OF 2008

The Companies Act of 2008 introduces the concept of business rescue and chapter 6 of this act (hereinafter referred to as chapter 6) has been described as the legislative template of corporate rescue in South Africa by Bradstreet.<sup>38</sup> The rationale for chapter 6 is to rescue a financially distressed company and the meaning of rescuing a company has either one of two objectives.<sup>39</sup> These objectives are found in the definition of business rescue and relate to either; restoring the company to a solvent entity or if that is not possible then a better return for creditors or shareholders as opposed to liquidation.<sup>40</sup> This indicates the legislature's intention at the start of chapter 6 to prefer business rescue over liquidation. The legislature expressly deals with the relationship between liquidation and business rescue by stating that if liquidation proceedings have already commenced those proceedings are suspended at the time the business rescue application is made.<sup>41</sup> The ways in which business rescue can commence are by special resolution or court order.<sup>42</sup> The latter option will only be discussed.

#### 2.1.1 COURT ORDERS TO BEGIN BUSINESS RESCUE

An affected person is capable of applying to court for an order placing a company under business rescue.<sup>43</sup> This can be done at any time so long as the company has not already filed a special resolution to commence business rescue.<sup>44</sup> The definition

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<sup>38</sup> Bradstreet op cit note 17 at 352-380.

<sup>39</sup> Companies Act 71 of 2008: S128(h).

<sup>40</sup> Companies Act 71 of 2008: S128(b)(iii).

<sup>41</sup> Companies Act 71 of 2008: S131(6).

<sup>42</sup> Companies Act 71 of 2008: S129 and S131.

<sup>43</sup> Companies Act 71 of 2008: S131.

<sup>44</sup> Companies Act 71 of 2008: S131.

of an affected person include a shareholder, director, registered trade union, employees or the employee's representative.<sup>45</sup> This has broadened the scope of business rescue from judicial management as it grants more people the opportunity to apply for business rescue.<sup>46</sup> Previously only the company, its creditors or one or more of its members had *locus standi* under judicial management.<sup>47</sup>

### 2.1.2 THE REQUIREMENTS AN AFFECTED PERSON HAS TO PROVE

Section 131(4)(a) requires an affected person to prove that:

1. the company is financially distressed;
2. 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
3. it is otherwise just and equitable to do so for financial reasons, and
4. there is a reasonable prospect for rescuing the company.<sup>48</sup>

Even when all these requirements are proved the court still has an overriding discretion whether to grant the application, dismiss it or place the company under liquidation.<sup>49</sup>

## 2.2 THE MEANING OF REASONABLE PROSPECTS

There is a general acceptance by academics and judges that the meaning of what reasonable prospects actually entails has not yet been adequately determined.<sup>50</sup>

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<sup>45</sup> Companies Act 71 of 2008: S128 (a).

<sup>46</sup> Companies Act 61 of 1973: S427.

<sup>47</sup> Companies Act 61 of 1973: S346.

<sup>48</sup> Companies Act 71 of 2008: S131.

<sup>49</sup> Companies Act 71 of 2008: use of the word "may" in S131 (4)(a).

<sup>50</sup> *Newcity Group (Pty) Ltd v Allan Pellow NO (577/2013) [2014] ZASCA 162.*

There currently exists an array of different interpretations and even more commentaries and critiques on these interpretations. Some writers such as Osade argue that one of the biggest downfalls of judicial management was the courts attitude towards it and more specifically the judicial interpretation of reasonable probability. He further argues that should business rescue have any chance of success it would require the courts to adopt a new fresh attitude that is flexible and unlike the approach used to interpret judicial managements requirements.<sup>51</sup>

The chronology of reasonable prospects in business rescue can be traced back to *Swart v Beagle Run Investments 25 (Pty) Ltd and Others*<sup>52</sup> which was the first case to deal with business rescue.<sup>53</sup> However, one of the most notable cases that has set the standard for reasonable prospects is *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd*<sup>54</sup>. This case can be seen as representing the majority of decisions dealing with business rescue during its first generation as it set a benchmark for the evidentiary burden that was followed as precedent when determining reasonable prospects.<sup>55</sup>

### 2.2.1 SOUTHERN PALACE INVESTMENTS 265 (PTY) LTD V MIDNIGHT STORM INVESTMENTS 386 LTD

Justice Eloff AJ, in *casu* attempted to create a sort of checklist approach when determining what reasonable prospects are.<sup>56</sup> He recognized the differences between

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<sup>51</sup> P, Osade 'Judicial Implementation of South Africa's new Business Rescue Model: A Preliminary Assessment' (2015) 4 *Penn State Journal of Law* 459-488.

<sup>52</sup> 2011 (5) SA 422.(GNP)

<sup>53</sup> Joubert op cit note 14.

<sup>54</sup> 2012 (2) SA 423 (WCC)

<sup>55</sup> *Southern Palace* Supra note 10.

<sup>56</sup> *Southern Palace* Supra note 10 at 24.

the test for the recovery requirement in judicial management and that in business rescue which was somewhat lower.<sup>57</sup> The only problem was that this case had the effect of setting the bar higher than the previous standard. Another criticism of this case was that it required a concrete plan to be placed before it which the court can inspect. This is not a requirement of the Companies Act of 2008, in fact chapter 6 specifically requires a business rescue plan to be adopted after business rescue has commenced as it is the duty of the business rescue practitioner and not the applicant or court.<sup>58</sup>

The checklist approach was divided into two categories. First, dealing with the primary objective of business rescue which was to restore the company to solvency and the second dealing with a better return for creditors and shareholders. Where an affected person relied on the primary objective Eloff AJ required an applicant to provide concrete and objective details regarding:

1. The likely costs of rendering the company able to commence with its intended business, or to resume the conduct of its core business;
2. the likely availability of the necessary cash resource in order to enable the ailing company to meet its day-to-day expenditure, once its trading operations commence or are resumed. If the company will be reliant on loan capital or other facilities, one would expect to be given some concrete indication of the extent thereof and the basis or terms upon which it will be available;

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<sup>57</sup> *Southern Palace* Supra note 10 at 21.

<sup>58</sup> Companies Act 71 of 2008: S140(d).

3. the availability of any other necessary resource, such as raw materials and human capital;
4. the reasons why it is suggested that the proposed business plan will have a reasonable prospect of success.<sup>59</sup>

It is quite clear from this list that the evidentiary burden placed on an applicant is strenuous and many of the requirements need details and information that may not be readily available to an 'affected person.'

Where an applicant relied on the secondary objective of business rescue they were required to provide concrete factual details of the:

1. Source, nature and extent of the resources that are likely to be available to the company;
2. The basis and terms on which such resources will be available.<sup>60</sup>

Both of these checklists are qualified by the fact that mere speculation will not suffice. This however is problematic and inconsistent with some of the requirements. For example, the requirement that there must be details on the resources that are likely to be available can only be speculated upon. Therefore, by asking the applicant for a plan to be placed before the court will require an amount of speculation as it deals with the future.<sup>61</sup> It is assumed that this speculation must be backed up and be reasonable. For example, where one alleges that the company is expecting a big order there must be some sort of correspondence to back up this expectation.

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<sup>59</sup> *Southern Palace* supra note 10 at 24.

<sup>60</sup> *Southern Palace* Supra note 10 at 25.

<sup>61</sup> *Southern Palace* Supra note 10 at 23.

This case attempted to create a system or to formulate a test because the framework failed to do so. Had subsequent cases given effect to the directions that an applicant is required to deal with why the company was in financial distress and propose a workable remedy that might have a reasonable prospect of success, then perhaps the first generation of cases relying on Eloff's judgment would have had a different outcome. The way in which Eloff AJ attempted to create a test was correct and he even commented on how each case must be dealt with on its own merits but the end result was simply too burdensome on an applicant.

### *2.2.2 OAKDENE SQUARE PROPERTIES (PTY) LTD V FARM BOTHASFONTEIN (KYLAMI) (PTY) LTD*

The next generation of cases dealing with the meaning reasonable prospects can be summed up in *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kylami) (Pty)*.<sup>62</sup> This was the first time the Supreme Court of Appeal (hereinafter referred to as the SCA) was asked to decide on an issue concerning business rescue.<sup>63</sup> The case dealt with the sale of a property and whether a better return could be obtained under business rescue as opposed to a forced sale in execution.<sup>64</sup> This case recognized the need for a lower threshold and attempted to simplify the determination of reasonable prospects. The court determined the extent of its discretion and the way it should be exercised. Its finding was that the courts should not exercise a strict discretion but a loose and flexible one.<sup>65</sup> This allows the court to take into account a wide range of factors and come to a value judgement on whether there are reasonable prospects. In

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<sup>62</sup> *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kylami) (Pty) Ltd* (609/2012) [2013] ZASCA 68.

<sup>63</sup> *Oakdene* supra note 60 at 5.

<sup>64</sup> *Oakdene* supra note 60 at 15.

<sup>65</sup> *Oakdene* supra note 60 at 19.

making this determination the court reasoned that the answer to whether there exists reasonable prospects is either a yes or a no and there is no middle ground where both answers could be correct.<sup>66</sup> The court was asked to rule on where reasonable prospects must stem from, as the appellants argued that all that was required was a reasonable prospect of a rescue plan. This interpretation was rejected by the SCA who followed the view that when interpreting reasonable prospects one must rely on one of the goals listed in s128(1)(b).<sup>67</sup>

The SCA set the bar lower than it previously was by requiring something more of a *prima facie* case or arguable possibility.<sup>68</sup> The courts directions are for courts to focus on the reasonable part of reasonable prospects meaning the prospects must be based on reasonable grounds.<sup>69</sup> The SCA rejected the view that there should be a checklist approach and held that it would be impractical to specify the way in which an applicant should show reasonable prospects.<sup>70</sup> However, in this case the court relied on factors such as the costs of business rescue in comparison to liquidator's fees. The appellants contended that a business rescue practitioner would be able to sell the property at a higher rate but the court rejected this as it failed to understand why. The factors relied on by the SCA in rejecting the application was that a liquidator gets paid a percentage of the value of the estate and a business rescue practitioner gets paid a daily rate.<sup>71</sup> This means the longer business rescue continues would mean it would become more expensive and would eventually result in the same value as a forced sale given the additional costs associated to business rescue. Another factor that was considered

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<sup>66</sup> *Oakdene* supra note 60 at 21.

<sup>67</sup> *Oakdene* supra note 60 at 31.

<sup>68</sup> *Oakdene* supra note 60 at 29.

<sup>69</sup> *Oakdene* supra note 60 at 29.

<sup>70</sup> *Oakdene* supra note 60 at 30.

<sup>71</sup> *Oakdene* supra note 60 at 34.

was that some of the creditors intended to oppose a business rescue plan, therefore even if the courts were to order business rescue the voting interest of the two creditors would be 60% at the meeting of creditors. This meant that they would object to the business rescue plan being adopted when the business rescue practitioner convenes a meeting of creditors if business rescue was ordered. The court expressly dealt with whether this point should be considered at this stage and it held that it should be because ordering business rescue would be futile if the creditors have already displayed their intention to object to the adoption of the plan.<sup>72</sup>

### **2.3 BACKGROUND OF *RICHTER V ABSA BANK LIMITED***

A company was placed in liquidation even though at the hearing it was contended business rescue would be a more viable option.<sup>73</sup> The court however ordered the final order to wind up the entity. The entity was a property holding close corporation and its income was from rentals as it leased out commercial property.<sup>74</sup> After liquidators were appointed and the winding up process had begun an employee had launched business rescue proceedings. He relied on the fact that he was an affected person in that he was an employee and the court a quo held he did have *locus standi*.<sup>75</sup> *ABSA's* argument was that the entity could no longer apply for business rescue as the final order of liquidation had already been granted. *ABSA's* view was that there can be reasonable prospect of success when the liquidation order was granted 6 months prior to the business rescue application.<sup>76</sup>

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<sup>72</sup> *Oakdene* supra note 60 at 38.

<sup>73</sup> *Richter* supra note 11 at 2.

<sup>74</sup> *Richter* supra note 11 at 2.

<sup>75</sup> *Richter* supra note 11 at 2.

<sup>76</sup> *Richter* supra note 11 at 4.

The High Court held that the company was not capable of business rescue as it was in liquidation and this decision was taken on appeal to the SCA. The issue that had to be determined was the proper meaning of 'liquidation proceedings' and whether it referred to only the period before a final order or included the period after the final order of liquidation was granted.<sup>77</sup> The court looked at the wording of s131 (1) which states: "an affected person may apply to a court at 'any time' for an order placing the company under supervision and commencing business rescue proceedings".<sup>78</sup>

The court emphasised the use of the words any time in s131 (1) as well in s131 (7) which states: "a court may make an order contemplated in subsection (4), or (5) if applicable, at any time during the course of any liquidation proceedings"<sup>79</sup>

The SCA relied on these two provisions to come to the conclusion that the legislature clearly intended business rescue to be preferable over liquidation and did not distinguish between pre and post final liquidation.<sup>80</sup> The SCA had criticised the High Court's view that the entity ceases to exist once a final order of liquidation had been granted and held the company was very much in existence, the only change was the control of the company.<sup>81</sup> The court considered whether liquidation meant prior to winding up because it often regarded the process after a final liquidation order had been granted as the winding up of a company but the SCA was of the view that the terms are used interchangeably and liquidation includes the process of winding the assets by a liquidator.<sup>82</sup>

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<sup>77</sup> *Richter* supra note 11 at 8.

<sup>78</sup> Companies Act 71 of 2008: s131(1).

<sup>79</sup> Companies Act 71 of 2008: s131(7)

<sup>80</sup> *Richter* supra note 11 at 17.

<sup>81</sup> *Richter* supra note 11 at 10.

<sup>82</sup> *Richter* supra note 11 at 11.

The SCA examined what constitutes reasonable prospects when a company is in liquidation and listed the following as possible indicators of reasonable prospects:

1. Being awarded a tender in liquidation which was applied for prior to liquidation;
2. being awarded a contract;
3. securing funding for a project; and
4. a creditor indicating a willingness to subordinate its claim.<sup>83</sup>

The court was of the view that reasonable prospects will exist during liquidation where there is evidence that 'business rescue will yield a better return for creditor or shareholder and jobs can be retained.'<sup>84</sup>

The court noted that by upholding the appeal it would lead to awkward results during the early stages of business rescue.<sup>85</sup> For example, what happens to the liquidators and who controls the company leading up to the court's decision on the business rescue application? The SCA was of the view that these impractical consequences should not be considered by a court as reasons to deny placing a company under business rescue.<sup>86</sup> The court took the approach that to disallow business rescue applications after a final order of liquidation would be to go against the aims which business rescue was specifically created for.<sup>87</sup> The main concern from *ABSA's* counsel was that if the court allowed such a liberal interpretation of s131 it will have negative impacts on liquidation.<sup>88</sup> It is against the background of this submission that has led to an analysis on what are the negative impacts and awkward results the court and *ABSA* are referring to. This case followed a liberal approach while aware of the

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<sup>83</sup> *Richter* supra note 11 at 15.

<sup>84</sup> *Richter* supra note 11 at 15.

<sup>85</sup> *Richter* supra note 11 at 16.

<sup>86</sup> *Richter* supra note 11 at 16.

<sup>87</sup> *Richter* supra note 11 at 15.

<sup>88</sup> *Richter* supra note 11 at 16.

fact that it may lead to confusing practical consequences. It is these effects and consequences that will be looked at to determine whether a liberal approach is the correct approach.

## CHAPTER 3: JURISPRUDENCE ON REASONABLE PROSPECTS

### 3.1 SUBSTANTIVE REASONING

In 1996, Alfred Cockrell<sup>89</sup> undertook a study where he analyzed the way in which South Africa's Constitutional Court reasoned during its first year in operation. In this study he argued that giving effect to the new broad-based value-oriented Constitution demanded a new style of substantive reasoning. He argued that the judiciary would have to undertake a new approach that shy's away from the mechanical application of rules. This new approach would require greater room for judicial discretion and pragmatic thinking in applying same. It was this discretion of the judiciary that he focused on. Cockrell argued that this discretion afforded to the judiciary was due to the open-ended wording of the Constitution and its constant reference to values.<sup>90</sup> These Constitutional values where seen as the spirit of the Constitution and mandated a court or tribunal to give effect to it when interpreting law.<sup>91</sup>

Cockrell distinguished between formal reasoning, which is the strict application of a rule and substantive reasoning which considered a variety of factors when applying the rules.<sup>92</sup> His study compared the formal vision of law that took place in the English system and the substantive vision of law in the American system and held that South African law would need to shift from the formal English system towards a more substantive American approach.<sup>93</sup> This required the judiciary to consider the implications of the rule and the purpose it was serving as well as other relevant factors.

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<sup>89</sup> A Cockrell 'Rainbow Jurisprudence' (1996) 12 *South African Journal on Human Rights* 1-38.

<sup>90</sup> Ibid at 2.

<sup>91</sup> The Constitution of South Africa: S39(2).

<sup>92</sup> Cockrell op cite note 89 at 3.

<sup>93</sup> Cockrell op cite note 89 at 5.

The conclusion reached in Cockrell's study was that during the first year in operation the Constitutional Court's decisions were without substance or direction and contained 'rainbow jurisprudence.'<sup>94</sup> This is a term coined by Cockrell that refers to an eloquent statement that on the face of it seems well thought out and well written, but at a second glance offers no real substance. He argued that this often occurred in first generation Constitutional Court cases because judges were tasked with building constitutional jurisprudence from nothing and this led to the repetition of what was required of the courts as opposed to the courts stating how it is going to achieve what was required.<sup>95</sup> This approach is comparable to first generation business rescue cases because the courts have recognized that 'reasonable prospects' demand a lower threshold than 'reasonable probability' in judicial management and have constantly repeated this statement without actually adding any substance on how to go about achieving this lower threshold.

In *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 LTD* the court sought to create directions and instructions and has been heavily criticized for not giving effect to 'reasonable prospects' but at least this was an expression by the judiciary to create directions and instructions on what is required of an applicant.<sup>96</sup> To say that the applicant is required to prove something less than judicial management is nothing more than 'rainbow jurisprudence.' Eloff JA, proposed a theory on how to do so and for that he deserves praise even though the actual outcome of his approach was incorrect.<sup>97</sup>

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<sup>94</sup> Cockrell op cite note 87 at 11.

<sup>95</sup> Cockrell op cite note 87 at 11.

<sup>96</sup> *Southern Palace* supra note 10 at 24.

<sup>97</sup> *Southern Palace* supra note 10 at 24.

Our Courts have recognized that our company law stems from the English system of law. Gamble J in *Nedbank v Bestvest*<sup>98</sup> in held that;

‘Our [South African] company law has for many decades closely tracked the English system and has often taken its lead from the relevant English Companies Acts and the judicial pronouncements thereon. The Act now encourages our Courts to look further afield and to have regard, in appropriate circumstances, to other corporate law jurisdictions, be they American, European, Asian or African, in interpreting the Act.’<sup>99</sup>

This case is important for South African law because it argued that a new approach to corporate rescue was needed, more specifically s5 and s7 required courts to consider foreign jurisdictions and adopt a purposive interpretation.<sup>100</sup> South African courts have adopted new approaches to interpretation and there are discrepancies whether the statute allows discretion or not. Writers have argued that the way the courts interpret the bill of rights differs from interpreting ordinary statutes.<sup>101</sup> These approaches have also been recognized by the judiciary who have stated that constitutional adjudication is value laden as opposed to interpreting a dispassionate statute such as those dealing with tax law.<sup>102</sup> This clearly shows that the courts approach to a statute is linked to the way in which it is drafted and the provisions of chapter 6 of the Companies Act 2008 are very purpose driven and open ended.

Chapter 6 of the Companies Act 2008 is specifically aimed at achieving the objectives of business rescue therefore its jurisprudence must center on these two objectives.

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<sup>98</sup> *Nedbank Ltd* supra note 34.

<sup>99</sup> *Supra* at 26.

<sup>100</sup> *Nedbank Ltd* supra note 34 at 25.

<sup>101</sup> I Currie and J De Waal. *The Bill of Rights Handbook*. 5ed. (2005) 145-188.

<sup>102</sup> *S v Mhlungu and Others* (CCT25/94) [1995] ZACC 4; 1995 (3) SA 86 ; 1995 (7) BCLR 793 (CC) para 111.

The SCA has expressed its view that when determining reasonable prospects, we focus on the objectives.<sup>103</sup> This approach is one that will give effect to the interpretation of a purpose-built system like chapter 6 of the Companies Act 2008. Adopting a purposive approach to the interpretation of business rescue applications must be done with caution because it deals with competing interests. However, it is still accepted that the best mode of interpretation in business rescue applications in a constitutional era is the purposive approach.<sup>104</sup> The boundaries and the way in which this approach has been applied can be seen in the following extract:

It seems to me then that a fresh approach must be adopted when assessing the affairs of "Corporate South Africa". The Legislature has pertinently charged the Courts with the duty to interpret the Act in such a way that, firstly, the founding values of the Constitution are respected and advanced, and, secondly so that the spirit and purpose of the Act are given effect to. Fundamental to the Act is the promotion and stimulation of the country's economy through, *inter alia*, the use of the company as a vehicle to achieve economic and social well-being. This must be done efficiently and in accordance with acceptable levels of corporate stewardship, all the while, balancing the rights and obligations of shareholders and directors in the company, its employees and any outside parties with which a company ordinarily interacts in the course of its business.<sup>105</sup>

Certain writers are of the view that the onus placed on an applicant to prove reasonable prospects are becoming less burdensome and that the courts are adopting

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<sup>103</sup> *Oakdene supra* note 60 at 29.

<sup>104</sup> *Nedbank Ltd supra* note 34 at 22

<sup>105</sup> *Nedbank Ltd supra* note 34 at 20.

a new approach.<sup>106</sup> The main reasoning for this lengthy transition by the courts to adopt or even accept a new style of reasoning can be compared to Cockrell's study where the Constitutional court had to adapt from a formal approach of reasoning to a substantive vision of law.<sup>107</sup> Our courts are used to the creditor friendly approach that has been referred to as the guillotining of a company.<sup>108</sup> This approach protects creditor's interests. Creditors are regarded as the primary concern when a company is in financial distress. Having said that, it is worth noting that business rescue requires a court to adopt a new debtor friendly approach. That now requires a court give greater attention to restoring the company to solvency or a better return for creditors where there exists a reasonable prospect. This significant change has led to the judiciary to be cautious and apply a step by step approach to find the perfect threshold as opposed to taking a gigantic leap that may have grave consequences to creditors if the bar is set too low all in one leap.<sup>109</sup>

### **3.2 WHAT SOURCES SHOULD BE USED TO DETERMINE REASONABLE PROSPECTS**

South African courts have focused mainly on company law jurisprudence dealing with judicial management with some reference to foreign law. This approach is criticized because in one breath a court recognizes that judicial management was a failure and then in another uses the same approach in dealing with business rescue. In order for business rescue to be successful the approach adopted by the courts should be completely divested from judicial management. The sources to determine 'reasonable

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<sup>106</sup> Joubert op cite note 14 at 563.

<sup>107</sup> Cockrell op cite note 89 at 3.

<sup>108</sup> Bradstreet op cite note 17 at 1.

<sup>109</sup> *Swart v Beagles Run Investments 25 (Pty) Ltd and Others* (2011 (5) SA 422 (GNP)) [2011] ZAGPPHC 103; 26597/2011 (30 May 2011).

prospects' should be found inherently in the Companies Act 2008 read with other references to it in law. The term 'reasonable prospects' is not one that is new to South African law and can be traced back to appeal cases as well as applications for condonation. The judiciary would be aware of this because judges are faced with condonation applications regularly as well as applications for leave to appeal. However, these sources were never used as a guide when the courts examined the standard of proof regarding 'reasonable prospects.' It is generally accepted that condonation applications and applications for leave to appeal do not bear a very high burden. Specifically because they inquire about the prospects of success in the future based on what is before it, without adjudicating over the full appeal or case.<sup>110</sup> The reason this approach should be considered is based on the fact that the Companies Act of 2008 contains a similar framework in that a court in terms of s131 looks at the prospects of success based on what's before it and the actual investigation into 'reasonable prospects' is done by the business rescue practitioner in terms of s141.<sup>111</sup> This is why leave to appeal and condonation cases can be of value in the sense that the s131 application can be seen as the application for leave to appeal or condonation and the actual appeal or main case is the business rescue practitioners thorough inquiry into reasonable prospects.<sup>112</sup> If courts adjudicating over business rescue cases considered the threshold of proof that applied in these sources, then an equilibrium will be reached far sooner than the step by step approach that is currently taking place.<sup>113</sup>

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<sup>110</sup> B G van der Walt 'Applications for leave to Appeal by Persons Convicted in Criminal Cases in the Magistrates; Courts (1946) 64 *SALJ* 230.

<sup>111</sup> Companies Act 71 of 2008: s141.

<sup>112</sup> Superior Courts Act 10 of 2013: s17.

<sup>113</sup> Van de Walt op cit note 110.

### 3.3 THE TEST FOR LEAVE TO APPEAL AND CONDONATION

The test for leave to appeal is dealt with in the Superior Courts Act which provides that;

Leave to appeal may only be given where the judge or judges concerned are of the opinion that –

- (a) (i) the appeal would have a reasonable prospect of success; or
  - (ii) there is some other compelling reason why the appeal should be heard, including conflicting judgements on the matter under consideration;
- (b) the decision sought on appeal does not fall within the ambit of section 1(2)(a)
- (c) where the decision sought to be appealed does not dispose of all the issues in the case, the appeal would lead to a just and prompt resolution of the real issues between the parties.<sup>114</sup>

This test was formulated from previous tests that were used in leave to appeal cases and it is important to understand the previous terminology that was used. The current study looks at the uncertainty regarding ‘reasonable prospects’ but this uncertainty has existed previously in leave to appeal cases where the courts had to examine what is meant by reasonable prospects.

The Appellate division was tasked to hear appeals and prior to 1935 had applied the following test;<sup>115</sup>

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<sup>114</sup> Superior Courts Act 10 of 2013: s17.

<sup>115</sup> South African Act 1909: s105.

1. If the appeal is on the facts, it must be manifest on the record that there has been a miscarriage of justice;
2. If the appeal is based on law, the question must be an arguable one.<sup>116</sup>

The reason I have referred to this test is founded on the fact that although the test does not specifically deal with reasonable prospects it has laid the foundation for subsequent tests and the test mentions the term 'arguable one.' As mentioned previously, the SCA requires an applicant in a business rescue application to show something more than a *prima facie* case or an arguable possibility.<sup>117</sup> The Appellate Division has dealt with cases dealing with the interpretation of 'arguable' and the standard that is required to prove an arguable question of law.<sup>118</sup> In fact the appellate division's interpretation is the exact test the SCA speaks about when referring to arguable possibility because it summarizes the meaning as follows'

'But if by arguable is meant that despite our adherence to our view already expressed in our judgement we are unable to characterise as impossible the entertainment by the Appellate Division of a different view, then the present case satisfied the requirement of being arguable.'<sup>119</sup>

This test simply means that a judge who has decided a case and is adjudicating over an application on leave to appeal his own judgement need simply be satisfied that there is a arguable possibility that the Appellate Division could entertain a different view. This threshold is very low and could be why the SCA requires something more than an arguable possibility in business rescue cases. The problem with the SCA's

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<sup>116</sup> *Rex v van Rooyen* 1935 T.P.D.

<sup>117</sup> *Oakdene* supra note 60 at 29

<sup>118</sup> *Rex v Mahomed* 1939 T.P.D.

<sup>119</sup> *Van de Walt* op cit note 110.

judgement is that it failed to explain what an arguable possibility is and can be classified as rainbow jurisprudence. The only direction on what an arguable possibility could mean would be by examining the Appellate Division's approach.

The Appellate Division rejected the argument that it should appear to a court in an application for leave to appeal that the applicant's appeal must be successful.<sup>120</sup> This is in line with current law which holds that in an application for leave to appeal the court will not consider issues that are dealt with by an appeal court.<sup>121</sup> This means that the question posed in leave to appeal cases that were dealt with under the 1935 amendment, was whether there was a reasonable possibility.<sup>122</sup>

This terminology is another problem that writers and judges are currently examining in business rescue cases because it has been argued that the test in s131 should have referred to reasonable possibility and not probability.<sup>123</sup> Writers have interpreted the SCA's approach to allow for the courts to apply discretion where there is a reasonable possibility and grant an order for business rescue.<sup>124</sup> The problems that are currently being faced by our courts in business rescue applications can be seen as a repetition of the problem where courts were uncertain on what standard to apply in leave to appeal cases. The uncertainty was caused by an amendment in 1935 which meant that applications for leave to appeal will be dealt with by the Provincial Division of the Supreme Court and not directly by the SCA.<sup>125</sup> This caused uncertainty on whether the Provincial Division applies the same standard as the Appellate Division

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<sup>120</sup> Van de Walt op cit note 109 at 229.

<sup>121</sup> *Greenwood v S* (20075/14) [2015] ZASCA 56 (30 March 2015): para 3.

<sup>122</sup> General Law Amendment Act 46 of 1935.

<sup>123</sup> A Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (unpublished LLD thesis, UNISA, 2010) 340.

<sup>124</sup> Joubert op cite note 14 at 557.

<sup>125</sup> Van der Walt op cit note 110 at 224.

or whether the test should be different. There is however clarity that the standard was the same for both courts as the test of 'an arguable one' used in Provincial Divisions of the Supreme Court is said to correspond with the term 'reasonable prospect' which the Appellate Division applied.<sup>126</sup> This sort of terminology or semantical arguments have plagued business rescue cases causing uncertainty that was already dealt with and decided by the Appellate Division who faced a similar problem. Terms such as 'arguable' have been used as a synonym with reasonable possibility of success as well as with reasonable prospects of success. The directions by the Appellate Division was that all these terms flow from 'arguable,' which simply mean that there are contentions made by the Applicant that have substance.<sup>127</sup> Therefore, the Appellate Divisions definition of reasonable prospects are; contentions that are backed up by substance. Could such a simple approach be the answer to business rescue's uncertainty over reasonable prospects or would it involve the courts finding their feet by stepping closer and closer to reaching this inevitable liberal threshold?

The current legislation dealing with leave to appeals specially refers to reasonable prospect in s17 as did the previous test which was; whether there was a reasonable prospect that another court may come to a different conclusion?<sup>128</sup> It is accepted that the new test places a higher bar on an applicant due to the inclusion of the word 'would.' The new test require

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<sup>126</sup> Van der Walt op cit note 108 at 233 and *Rex v Mahomed* 1939 T.P.D.

<sup>127</sup> Van der Walt op cit note 108 at 232.

<sup>128</sup> *Commissioner of Inland Revenue v Tuck* 1980 (4) SA 888 (T) 890B.

es that the case 'would' have a reasonable prospect of success as opposed to 'may' have a reasonable prospect of success.<sup>129</sup> This shows that the test for reasonable prospects can be qualified but in s131 the way in which it is written is very open ended.

There are clearly a lot of jurisprudence on reasonable prospects when examining business rescue applications but our courts have confined its approach to either looking at judicial management or working from a blank canvas. This is the wrong approach because 'reasonable prospects' are written about existentially in cases dealing with leave to appeals both in a civil and criminal sense.<sup>130</sup> Cases dealing with absolution for instance also refer to prospects of success as well as condonation applications.<sup>131</sup> The courts when determining condonation applications exercise a discretion after taking into account the degree of lateness, the explanation, the importance of the case and the prospects of success.<sup>132</sup> It is only logical that a condonation application will fail where there are no prospects of success in the main case as it becomes futile to grant condonation. Reasonable prospects are not a new term in our law and our courts have given expression to this term both in a civil law sense and a criminal law sense. Previously criminal courts when determining applications for a discharge in terms of s174 of the Criminal Procedure Act 51 of 1977 used to consider whether there was a reasonable possibility whether the defence's case may supplement the prosecution's case.<sup>133</sup> This however is no longer applicable but the point to be taken from this is the terminology and jurisprudence on reasonable prospects are out there and there needs to be a shift away from judicial management

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<sup>129</sup> Superior Courts Act 10 of 2013: s17.

<sup>130</sup> D Smit and S Madikizela 'A Critical Analysis of Absolution from the Instance of South African Labour Law with Specific reference to the CCMA' (2016) 79 *Journal for Contemporary Roman Dutch Law* 87.

<sup>131</sup> Madikizela op cit note 119 at 91.

<sup>132</sup> *Melane V Southern Insurance Co Ltd* 1962 (4) SA 531 (A.D) 532.

<sup>133</sup> *S v Shupping* 1983 2 SA 119 (B).

and towards the inherent values of the Companies Act 2008 read with the above examples.

### **3.4 IS THE TEST FOR REASONABLE PROSPECTS SUBJECTIVE OR OBJECTIVE AND WHAT FACTORS SHOULD BE CONSIDERED?**

The use of the word 'reasonableness' implies objectivity. This is evident from the other tests like the 'reasonable person' test that is used to determine negligence. The subjectivity arguments stem from two variables. The first variable will be the type of company. This can range from a property holding entity to a manufacturing-based entity. In a property holding entity as in *Richter v ABSA*<sup>134</sup> there often is not any business or transactions unless the company leases its property. In a property holding entity there will not be as many employees as in an entity that employs staff in a factory. This is a basic example that shows companies in different industries and sectors will need a more specific test. One might suggest a reasonable based test similar to that of an expert where the test is what would a reasonable expert do? This sort of industry specific standard will require a court to look at what is reasonable for a company in that specific industry.<sup>135</sup> This approach was attempted by Gamble J, in *Nedbank v Bestvest*<sup>136</sup> where the learned judge attempted to create a checklist approach for the specific case which dealt with an incomplete building as the company's only asset.<sup>137</sup> The court required the applicant to set out the costs of finishing the construction and the accessibility of finance to do so.<sup>138</sup> Furthermore, what commercial prospects can be predicted if the building were to be finalized.<sup>139</sup> This

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<sup>134</sup> (20181/2014)[2015]ZASCA 100.

<sup>135</sup> *Nedbank* op cite note 34 at 43.

<sup>136</sup> *Ibid*

<sup>137</sup> *Nedbank* op cite note 34 at 1.

<sup>138</sup> *Nedbank* op cite note 34 at 43.

<sup>139</sup> *Nedbank* op cite note 34 at 43.

approach is flexible towards the type of company while still being able to adopt the purposive approach mandated by s7 of the Companies Act 2008.

The second variable is the time the application is made. What might be a 'reasonable prospect' when a company has been placed in liquidation for a week, might not be so reasonable after a liquidator has already incurred expenses during the winding up period. To illustrate the second variable, a company that relies on the primary objective of business rescue gets awarded a contract within a week after being placed in liquidation. This will bring in a profit of R100 000.00 (one hundred thousand rands). Therefore, there is a reasonable prospect of the company settling its debt which is currently at R90 000.00 (ninety thousand rands). Had this same contract been awarded 3 months into the winding up process, the liquidator would already have incurred expenses to the amount of R70 000.00 (seventy thousand rands) in addition to the R90 000.00 (ninety thousand rands). This makes the contract not so "reasonable" anymore. One can still make out a case in terms of the secondary objective of business rescue. Namely, that allowing the company to fulfill the contract will result in a better return for creditors and shareholders. This is another reason why business rescue can be preferred over liquidation as it allows the company to continue to trade even if it is just to fulfill a contract.

A problem can occur in such an example where an applicant relies on the first objective, but the matter should have been dealt with under the secondary objective and one should expect a court to apply the principal of substance over form and apply its discretion and grant an order in terms of the secondary objective as opposed to

liquidation.<sup>140</sup> The business rescue regime has tasked a court to look at the first objective. If that fails, then the second objective and lastly liquidation.<sup>141</sup> This sequence of events is based on a liberal interpretation as the courts require an applicant to specify which objective is relied on.<sup>142</sup> However, the spirit of chapter 6 and substantive reasoning demands a court to make a value judgement that encompasses the overall purpose of business rescue. This can allow a court to grant an order for business rescue even when the wrong objective of business rescue was relied on so long as the substance is present.

It is fair to say that the standard should remain, but the factors considered will differ from each case as well as the weight attached to those factors, depending on the stage of the winding up process. This means that judicial discretion is applied when attributing weight to the factors put forward by the applicant. By looking at case law applicants have put forward various factors and the most common being:

1. The property can be sold for more than it would in a forced sale;<sup>143</sup>
2. If a business rescue practitioner can raise post commencement finance to finish off current projects;<sup>144</sup>
3. The company is awarded a contract during liquidation;<sup>145</sup>
4. The moratorium on creditors enforcing their claims will allow the company to get back to solvency;<sup>146</sup>

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<sup>140</sup> Companies Act 71 of 2008: s128(b)(iii).

<sup>141</sup> *Nedbank* op cite note 34 at 53.

<sup>142</sup> *Southern Palace* supra note 10 at 24.

<sup>143</sup> *Oakedene* supra note 60 at 15.

<sup>144</sup> *Nedbank* op cite note 34 at 51.

<sup>145</sup> *Richter* supra note 11 at 15.

<sup>146</sup> *Gormley v West City Precinct Properties (Pty) Ltd and Another, Anglo Irish Bank Corporation Ltd v West City Precinct Properties (Pty) Ltd and Another* (19075/11, 15584/11) [2012] ZAWCHC 33 para 3.

5. That a company is not operational in liquidation but will be during business rescue;<sup>147</sup>
6. A major creditor writing off completely or a portion of their claim;<sup>148</sup>
7. The business has secured funding.<sup>149</sup>

The courts approach to these contentions has been quite inflexible. For example, even where an applicant could provide valuations that the property to auctioned was worth a specific amount the courts could not see how it would yield a better return than in business rescue as opposed to a forced sale.<sup>150</sup> Our courts have focused on a variety of other factors arguing against a liberal approach, such as the fact that a business rescue practitioner earns a daily fee compared to a liquidator who earns a percentage fee meaning that the proposed costs of business rescue should be considered as a factor against there being a reasonable prospect.<sup>151</sup> Courts have also accepted a creditors intention to oppose the adoption of a business rescue plan as a factor to dismiss a business rescue application.<sup>152</sup> This approach is highly detrimental to business rescue because the process of the actual rescue takes place once a business rescue practitioner has been appointed and if the courts do not allow that point to even occur the system becomes futile. The judiciary by adopting a liberal approach and focusing on the prospects side of the argument as opposed to relying on a creditor's opposition will give effect to the spirit of s7.<sup>153</sup> This does not mean that a business rescue application is defenceless, it simply means that a valid defence

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<sup>147</sup> *Van Staden v Angel Ozone Products CC and Others* (54009/11) [2012] ZAGPPHC 328; 2013 (4) SA 630 (GNP): 41.

<sup>148</sup> *Richter* supra note 11 at 15.

<sup>149</sup> *Richter* supra note 11 at 15.

<sup>150</sup> *Oakedene* supra note 60 at 16.

<sup>151</sup> *Nedbank* supra note 34 at para 60 and *Oakedene* supra note 60 at 36.

<sup>152</sup> *Oakedene* supra note 60 para 37.

<sup>153</sup> Companies Act 71 of 2008: s7.

against reasonable prospects should be prejudice suffered by creditors. Factors like a creditor's intention to oppose the adoption of a business plan are factors that are not ripe and where courts rely on these factors they imply an unwillingness to trust and rely on the procedural safeguards provided for by the Companies Act of 2008. The Companies Act 2008 specifically deals with a situation where a business rescue plan was objected to and part C of chapter 6 deals with the rights of affected persons.<sup>154</sup> If the courts do not allow the mechanism to operate and put the cart before the horse they would effectively make this mechanism suffer the same fate of judicial management.

The enquiry into reasonable prospects is not only done by the courts, in fact there are two enquiries into reasonable prospects. The first enquiry is in terms of s131 where a court must be satisfied that there is a reasonable prospect of rescuing the company. The second enquiry is done by the business rescue practitioner in terms of s141 which states that:

'As soon as practicable after being appointed, a practitioner must investigate the company's affairs, business, property, and financial situation, and after having done so, consider whether there is any reasonable prospect of the company being rescued.'<sup>155</sup>

The legislature clearly gave the business rescue practitioner a duty to determine if there are reasonable prospects. This duty has specific instructions that require the

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<sup>154</sup> Companies Act 71 of 2008: Chapter 6 Part C.

<sup>155</sup> Companies Act 71 of 2008: s141.

practitioner to examine the affairs, business, property and financial situation and implies a thorough investigation. This thorough investigation was not listed in s131 and all that was referred to was reasonable prospects without giving the courts the same specific directions that was given to a business rescue practitioner. This can be done for two reasons. Firstly, the main role player in business rescue applications is the business rescue practitioner and not the courts and given that a court's duty is to adjudicate over many cases, the amount of available evidence an affected person has to present to court is limited which leads to the courts only being able to decide on a matter with limited material available. A business rescue practitioner on the other hand will be given access to all the material and will be placed in a better position to make this determination and will have more time to do so.<sup>156</sup> The second reason is that this provides for a procedural safeguard in cases where the courts granted business rescue and the business rescue practitioner after considering all the affairs, business, property and financial situations realizes that there is no reasonable prospect. Upon coming to this conclusion the practitioner need not waste time continuing this process and can inform the court and all affected person that the company should be liquidated.<sup>157</sup> The second factor is very important because it is a measure that provides safety for creditors and is a factor the courts should consider when adjudicating over business rescue applications.

The creation of s141 should mean that the courts when determining reasonable prospects in terms of s131 should do so in a liberal manner because to do so will at least allow the main role player a chance to use the system.<sup>158</sup> Given that a business

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<sup>156</sup> Companies Act 71 of 2008: Chapter 6 Part D.

<sup>157</sup> Companies Act 71 of 2008: S141.

<sup>158</sup> *Van Staden* supra note 142 at 42.

rescue practitioner would be adequately qualified and trained the ultimate decision of whether the company can be turned around using his skill and knowledge should be left to his discretion. This creates an element of subjectivity and allows for potential abuse by a business rescue practitioner but as was mentioned a liberal interpretation will lead to awkward results.<sup>159</sup> Another aspect will be the regulation of practitioners and sanctions that can deter practitioners abusing their powers.<sup>160</sup>

The principal of checks and balances allows the judiciary to limit the power of the legislature but in this case the judiciary is second guessing chapter 6 of the Companies Act 2008.<sup>161</sup> The broad purpose of the Companies Act 2008 is to develop South Africa's economy by creating an efficient mechanism to rescue financially distressed companies and chapter 6 gives effect to that purpose.<sup>162</sup> If the courts do not reach an equilibrium in the test for reasonable prospects the legislature might be forced to make an amendment in order to allow business rescue the chance to succeed by expressly lowering the standard or giving clear directions on how to interpret it.

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<sup>159</sup> *Richter* supra note 11 at 16.

<sup>160</sup> Bradstreet op cit note 27 at 195.

<sup>161</sup> *S v Makwanyane and Another* (CCT3/94) [1995] ZACC 3; 1995 (6) BCLR 665; 1995 (3) SA 391; [1996] 2 CHRLD 164; 1995 (2) SACR 1 104.

<sup>162</sup> Companies Act 71 of 2008: s7.

## CHAPTER 4: CONSEQUENCES OF ADOPTING A LIBERAL INTERPRETATION

In *Richter v ABSA*<sup>163</sup> it was contended that a liberal interpretation will have detrimental consequences to liquidations and creditors' interests. The first part of this chapter focuses on how creditors' interests are protected by procedural safeguards. It was also accepted in *Richter v ABSA* that a liberal approach to granting business rescue applications when a company is already in liquidation will lead to awkward results.<sup>164</sup> These awkward results are discussed in the second part of this chapter.

### 4.1 PREJUDICE TO CREDITORS

#### 4.1.1 THE MORATORIUM

When a company is in business rescue it enjoys breathing space from creditors enforcing claims.<sup>165</sup> This statutory moratorium has been referred to as a prohibition of all legal proceedings including enforcement action.<sup>166</sup> This means that a creditor's right to enforce its claim against a company in business rescue is affected. A creditor suffers prejudice by the operation of a moratorium but this prejudice is not arbitrary or without remedy as the Companies Act 2008 aims to create an efficient financial rescue regime that balances all the rights of stakeholders.<sup>167</sup> It is important to note that a creditor does not lose its right to claim against a company nor is it suspended during business rescue. To say that a moratorium prohibits all legal proceedings or suspends a creditors rights during business rescue would be incorrect because a creditor has recourse in terms of s133(a) to s133(f).<sup>168</sup> It would be correct to follow the approach in

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<sup>163</sup> *Richter* supra note 11 at 16.

<sup>164</sup> *Richter* supra note 11 at 16.

<sup>165</sup> Companies Act 71 of 2008: s133.

<sup>166</sup> *Redpath and Merchant West* supra note 25.

<sup>167</sup> Companies Act 71 of 2008: s7.

<sup>168</sup> Companies Act 71 of 2008: s133.

*Booyesen v Jonkheer Boerewynmakery (Pty) Ltd*<sup>169</sup> which refers to the effect of the moratorium on a creditor's right to claim as a procedural limitation. The procedural safeguards in this regard are s133 and s134 of the Companies Act 2008 which provide a procedural hurdle that has to be discharged by a creditor before they can enforce their claim, furthermore s134 ensures that a secured creditor's property remain protected during business rescue.<sup>170</sup> Another procedural safeguard is s132 of the Companies Act 2008 which mandates business rescue to be temporary in nature.<sup>171</sup>

#### 4.1.2 LENGTH OF BUSINESS RESCUE

Where a company is in liquidation, a liquidator's duty is to realize the assets of the insolvent estate and distribute it to creditors as soon as possible.<sup>172</sup> In business rescue this is not so, and the business rescue practitioner does not represent the *concorsus creditorum*.<sup>173</sup> However, a business rescue practitioner is still placed in a fiduciary role and has similar powers like a liquidator.<sup>174</sup> This means that if it is uncovered during his investigation that there has been fraudulent or reckless trading he can recover the amounts from directors or shareholders for loss suffered by the company.

The notion that time is money means that there is a value attached to a creditor waiting for a dividend. In a liquidation it might be a few cents on the rand, but it is speedy. In business rescue it will take longer and there is no guarantee that the reasonable prospects will materialize to render a greater return for a creditor. This means that a creditor runs the risk of waiting for business rescue to fail and then receiving a few

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<sup>169</sup> *Booyesen* supra note 24.

<sup>170</sup> Companies Act 71 of 2008: s133-134.

<sup>171</sup> Companies Act 71 of 2008: s132.

<sup>172</sup> Insolvency Act 24 of 1936: s82.

<sup>173</sup> R Sharrock, K van der Linde and A Smith. *Hockley's Insolvency Law*. 9<sup>ed</sup>. (2012) 254.

<sup>174</sup> *Ibid*.

cents on the rand just as he might have had received if company had been liquidated at the outset. The argument on behalf of the creditor is that had they received a few cents on the rand from the liquidation before business rescue it would have been of more value to them.

The position of an unsecured creditor may be better in business rescue because usually where an entity has no assets, creditors are reluctant to prove a claim due to the risk of paying a contribution but in business rescue a company is given a lifeline.<sup>175</sup> If business rescue succeeds, then an unsecured creditor has a greater chance of receiving a dividend. This is basically the incentive business rescue offers to creditors; that business rescue offers the chance of the highest possible return.<sup>176</sup> The position of creditors waiting to receive what they are legally entitled to is similar to the position of a commercial landlord who acquires property for business purposes and seeks to evict an unlawful occupier.<sup>177</sup> In the *PE Municipality case*<sup>178</sup> the court held:

Thus, PIE [Prevention of Illegal Eviction From and Unlawful Occupation of Land Act 1998] expressly requires the court to infuse elements of grace and compassion into the formal structures of the law. It is called upon to balance competing interests in a principled way and to promote the constitutional vision of a caring society based on good neighbourliness and shared concern. The Constitution and PIE confirm that we are not islands unto ourselves. The spirit of ubuntu, part of the deep cultural heritage of the majority of the population, suffuses the whole constitutional order. It combines individual rights with a

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<sup>175</sup> Ibid at 183.

<sup>176</sup> Bradstreet op cite note 17 at 356.

<sup>177</sup> *City of Johannesburg Metropolitan Municipality v Blue Moonlight Properties 39 Ltd and Another* (CCT 37/11) [2011] ZACC 33: 38.

<sup>178</sup> *Port Elizabeth Municipality v Various Occupiers* 2004 (12) BCLR 1268 (CC)

communitarian philosophy. It is a unifying motif of the Bill of Rights, which is nothing if not a structured, institutionalised and operational declaration in our evolving new society of the need for human interdependence, respect and concern.<sup>179</sup>

Eviction cases recognize that a person's occupation is unlawful but still grant that person rights in law based on principles and values such as ubuntu.<sup>180</sup> This compassionate approach can be similar to the liberal approach to handling business rescue cases where a creditor does not lose its claim but it is limited during business rescue. Eviction cases in terms of the Prevention of Illegal Evictions and Unlawful Occupation of Land Act looks at what is just and equitable and takes into account various factors to make this determination.<sup>181</sup> I am in no way suggesting the right to adequate housing is as important as the rights of a company in business rescue but only that the judiciary can adopt a similar approach to handling business rescue cases. A creditor will definitely suffer prejudice the longer the amounts owed to it are outstanding but the courts in eviction cases have held that values and principles simply require a lessor to tolerate an unlawful occupier for a certain period of time and not indefinitely. If South African company law shifts to this compassionate substantive approach that takes African principles of law such as ubuntu into company law then creditors might have to accept that business rescue is only temporary and the time frames specified in s133 are a procedural safeguard.<sup>182</sup> This allows judicial oversight after 3 months to ensure that the process has not lost its reasonable prospects and

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<sup>179</sup> *Port Elizabeth Municipality v Various Occupiers* 2004 (12) BCLR 1268 (CC) at 37.

<sup>180</sup> *Blue Moonlight Properties 39 Ltd* supra note 172 at 38.

<sup>181</sup> Prevention of Illegal Eviction from and Unlawful Occupation of Land Act 19 of 1998.

<sup>182</sup> *Blue Moonlight Properties 39 Ltd* supra note 172 at 38.

gives creditors an opportunity to oppose any application for an extension by the business rescue practitioner.

#### *4.1.3 POST COMMENCEMENT FINANCE*

This is a system that aims at encouraging persons to invest money in a company in business rescue in the hope that the company regains financial stability to pay back the loans.<sup>183</sup> The issues surrounding post commencement finance are the ranking of claims which places creditors who provide post commencement finance only second to the costs and fees of the business rescue practitioner.<sup>184</sup> It is obvious that this was done as an incentive for persons to invest in companies in business rescue but the problem is that it makes a pre commencement creditor feel as if the post commencement creditors have jumped the queue. On the other hand, a pre-commencement creditor might recognize that the post commencement creditor is taking a greater risk which may benefit both types of creditors if the reasonable prospects materialize. However, if the reasonable prospects don't materialize then the new creditor outranks the old one. Given that the incentive is serving a legitimate purpose it's hard to expect any other way to get a person to throw good money after bad money and take such a risk. This means creditors will have to rely on the procedural safeguards which are s134 of the Companies Act 2008 and voting at the adoption of a business rescue plan.<sup>185</sup>

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<sup>183</sup> Companies Act 71 of 2008: s135.

<sup>184</sup> Companies Act 71 of 2008. S135(3).

<sup>185</sup> Companies Act 71 of 2008: s152.

#### 4.1.4 A BUSINESS RESCUE PLAN

The rescuing of a company takes place in the business rescue plan. It will be fair to term the business rescue plan as the most important part of the process because it will specify what is to be done to rescue the company. Creditors play a role in developing this plan and eventually have a say on its implementation.<sup>186</sup> Once a plan has been created the business rescue practitioner will convene a meeting with the creditors and persons with a right to vote on its implementation.<sup>187</sup> At this meeting each creditor will have a vote equal to their interests on whether to adopt the business rescue plan or not.<sup>188</sup> This is another procedural safeguard that makes sure the creditors have a say in their interests. The position changes when a plan is rejected because a business rescue practitioner is empowered to apply to court to set aside the vote rejecting the plan on the grounds that it was inappropriate.<sup>189</sup> This means that a creditor has a luxury of choice but that choice must be exercised in an appropriate manner which is problematic because different creditors have different interests to protect. Another safeguard that seeks to balance the goals of business rescue with creditors interests are the provisions dealing with binding offer.<sup>190</sup> Section 153 holds that where a plan has been rejected any affected person may make a binding offer to those affected persons who voted against the adoption of the business rescue plan. The words 'binding offer' were interpreted in *African Banking Corporation of Botswana v Kariba Furniture Manufacturer & Others*,<sup>191</sup> but this study does not delve further into

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<sup>186</sup> Companies Act 71 of 2008: s150.

<sup>187</sup> Companies Act 71 of 2008: S151.

<sup>188</sup> Companies Act 71 of 2008: S152.

<sup>189</sup> Companies Act 71 of 2008: S153.

<sup>190</sup> Companies Act 71 of 2008: S153.

<sup>191</sup> *African Banking Corporation Botswana v Kariba Furniture Manufacturers & Others* (228/2014) [2015] ZASCA 69 (20 May 2015).

procedural safeguards other than noting them as a factor that should be considered by a court.

#### 4.1.5 BUSINESS RESCUE PRACTITIONER ABUSING HIS POWERS

The fees of a business rescue practitioner are prescribed by a tariff prepared by the Minister of the Department of Trade and Industry in the regulations of the Companies Act 2008.<sup>192</sup> The fees are charged per day and this means that the longer business rescue continues the greater the fees.<sup>193</sup> This approach seems counterproductive as opposed to a flat rate, percentage-based fee or success fee. In practice a company through one or more of its directors or shareholders may attempt to frustrate creditors by applying for business rescue and seeking an order that a business rescue practitioner who they are close to be appointed. In these instances a business rescue practitioner may fail to comply with his duties and delay the process.<sup>194</sup> In situations where a business rescue practitioner fails to comply with their fiduciary duties and act mala fide, creditors can apply for the removal of that business rescue practitioner.<sup>195</sup> The proof required to prove that a business rescue practitioner has acted contrary to what was required of him is quite simple given the procedural requirements he has to follow. This means that the framework has provided a procedural safeguard which requires strict compliance by the business rescue practitioner that takes the form of a step by step approach and where the practitioner does not follow the sequence prescribed, he can be removed by a court order.<sup>196</sup> The way the framework operates is that it allows a business rescue practitioner enough room to exercise his wide range

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<sup>192</sup> Companies Act 71 of 2008: s143.

<sup>193</sup> Companies Act 71 of 2008: Regulation 128.

<sup>194</sup> *Lizemore* supra note 28.

<sup>195</sup> Companies Act 71 of 2008: s139.

<sup>196</sup> Companies Act 71 of 2008: s139.

of powers but there are always steps that have to be followed and where this is not done creditors have recourse to the courts. In addition to this remedy, creditors who suffer damages as a result of the business rescue practitioner's negligence, can claim same from the practitioner directly.

## **4.2 AWKWARD CONSEQUENCES OF A LIBERAL APPROACH TO REASONABLE PROSPECTS AFTER A FINAL ORDER OF LIQUIDATION**

### *4.2.1 THE LOCUS STANDI OF EMPLOYEES*

Once a company has been placed in liquidation an affected person has *locus standi* to apply to court for an order placing the company in business rescue.<sup>197</sup> Employees of a company qualify as affected persons. In *Richter v ABSA*<sup>198</sup> the applicant was a general manager employed by the company who had made application to court 6 months after the final order of liquidation had been granted. The case has been criticized by Loubser<sup>199</sup> who argues that the court respectfully failed to consider s38(9) of the Insolvency Act. Section 38(1) of the Insolvency Act suspends all contracts of employment between the Insolvent entity and its employees.<sup>200</sup> The suspension continues until it is automatically terminated after 45 days of the liquidator being appointed or before 45 days should the liquidator terminate the contract expressly in terms of s38(4).<sup>201</sup> These two situations raise an issue for employees who desire to apply for an order placing the company under business because the Insolvency Act regards the employment relationship as terminated.

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<sup>197</sup> Companies Act 71 of 2008: s131(1).

<sup>198</sup> *Richter* supra note 11 at 2.

<sup>199</sup> Loubser op cit note 18 at 29.

<sup>200</sup> Insolvency Act 24 of 1936: s38(1).

<sup>201</sup> Insolvency Act 24 of 1936: s38(4).

The court a quo in *Richter v ABSA*<sup>202</sup> had to decide whether an employee had *locus standi* as an affected person as an issue in *limine*. The court examined the effect of s38 of the Insolvency Act and held that the contracts of employment are only suspended and not terminated. The court then went on to decide that the real issue is not whether the employment contract was suspended but rather whether the employee's status as an affected person was terminated. This approach means that where a contract of employment has been terminated either automatically or by the liquidator an employee will not lose its right to institute action in terms of s131 of the Companies Act 2008.

The court a quo held that chapter 14 of Companies Act 1973 still applies when winding up companies and that it holds that the law of insolvency applies *mutatis mutandis* when a company can't pay its debts.<sup>203</sup> If a court were to follow this strict approach and apply the law as it is mentioned, it would certainly mean an employee loses its right to sue after their contracts are terminated. The word 'terminate' implies something has come to an end and it would be very difficult to criticize this approach. However, the courts when determining whether an employee whose contract of employment has terminated has *locus standi* might consider adopting a broad approach to s128. A court can interpret that there is an employment relationship or that there was one that has been terminated *ex lege* and for the purposes of s128(1)(a) an employee whose right has been terminated still has *locus standi*. This approach can be similar to the Labour Appeal Courts broad interpretation of who an employee is.<sup>204</sup> The court in *Richter v Bloempro*<sup>205</sup> took the view that the contracts were only suspended and not terminated and thus the employee had *locus standi*.

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<sup>202</sup> *Richter v Bloempro CC and Others* 2014 (6) SA 38 (GP) at 13.

<sup>203</sup> *Richter* supra note 192 at 11.

<sup>204</sup> *Kylie v CCMA and Others* (CA10/08) [2010] ZALAC 8; 2010 (4) SA 383 (LAC).

<sup>205</sup> *Richter* supra note 192 at 21.

#### 4.2.2 WHO IS IN CONTROL OF THE COMPANY

An awkward result of business rescue after liquidation can be the control of a company. When a company is in liquidation a liquidator is in control of the company, but that position changes the moment a business rescue application is made.<sup>206</sup> There have been various different interpretations on when a business rescue application is made and there is now general acceptance once the application has been filed in court and served on the affected parties the application has been made.<sup>207</sup> This interpretation would mean a liquidator's powers are suspended until the court has adjudicated over the application. This period from the time the application is made to the court deciding the application causes uncertainty as to who is in control of the company.

In cases where a company is in business rescue and a creditor successfully applies for the company to be placed in liquidation and that decision is appealed the courts have adopted the historic creditor friendly approach and held the estate vests with the liquidators pending the appeal.<sup>208</sup> This approach is contrary to the purpose of business rescue and has been criticized by other cases such *Lawrence Maroos v GCC Engineering*<sup>209</sup> where the court appointed an independent person to control the company pending a final order of liquidation when a company was already in business rescue and the provincial order of liquidation had been granted.

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<sup>206</sup> Companies Act 71 of 2008: S133(6).

<sup>207</sup> *Standard Bank* supra note 33.

<sup>208</sup> *Ex Parte: Nell N.O. and Others* (45279/14) ZAGPPHC 620:2014 (6) SA (GP) (29 July 2014) at 54.

<sup>209</sup> Unreported case of *Lawrence Maroos and Others v GCC Engineering (Pty) Ltd* handed down on the 15<sup>th</sup> of June 2017

The general approach of the judiciary is that there is a lacuna in the law due to business rescue being new in our law.<sup>210</sup> This current lacuna caused by a business rescue application being made after a company was already in liquidation was dealt with in *Janse Van Rensburg v Cardio Fitness Properties (Pty) Ltd*<sup>211</sup> where a liquidator sought a spoliation remedy to take back control of the assets of a company in liquidation during the period between the business rescue application being made and the business rescue application being decided. The court held that while the liquidation proceedings have been suspended the intention of the legislature was to stop the process of liquidation and it did not mean that the provincial liquidator's duties to simply take control and preserve the assets are suspended.<sup>212</sup> This approach cannot be a one size fits all solutions because it dealt with provisional liquidators and the court recognized that the provisional liquidator's duties are to preserve the assets until a final liquidator is appointed. This means such an approach would not be tenable once final liquidators are appointed and a business rescue application is made.

#### 4.2.3 BUSINESS RESCUE AFTER BUSINESS RESCUE

Section 131(1) states'

"Unless a company has adopted a resolution contemplated in section 129, an affected person may apply to a court at any time for an order placing the company under supervision and commencing business rescue proceedings."

Our courts have interpreted s131(1) to mean that a company cannot be ordered to be placed in business rescue whilst it is already in business rescue in terms of s129 but this does not prevent the courts from adopting other interpretations. For example, a

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<sup>210</sup> *Janse Van Rensburg N.O & Another v Cardio Fitness Properties (Pty) Ltd & Others* (46194/13) [2014] ZAGPJHC 40 at 6.

<sup>211</sup> *Janse* supra note 204.

<sup>212</sup> *Janse* supra note 204.

court can interpret this section to mean that when a company has already filed a resolution to commence business rescue and the regime has failed it automatically bars any further court application by an affected person.

A liberal approach to business rescue may allow for business rescue applications to succeed in cases where previous business rescue applications have been dismissed or the previous business rescue had failed. Currently the most liberal approach can be seen in *Richter v ABSA*<sup>213</sup> which can be classified as the third generation of cases which shifts the attitude of the courts to being debtor friendly. Courts have previously considered why the company did not voluntarily file for business rescue as a factor when an application for business rescue is brought. This can be a factor where a company through its directors or shareholders had been acting with an ulterior motive and can cause a court to apply its discretion even when all the requirements of s131 are met and dismiss the application.<sup>214</sup> In cases where innocent employees or creditors apply for business rescue, the courts might not consider this as a negative factor but rather as a positive one which will allow a business rescue practitioner the opportunity to investigate the affairs and reclaim any amounts from directors or shareholders who have been trading recklessly.

The point which is made is that a factor might be relevant but more so to a specific affected person. This approach will support the view that whenever there are new facts that have arisen an affected person can make an application for business rescue notwithstanding the fact that business rescue applications have previously been made

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<sup>213</sup> *Richter* supra note 11.

<sup>214</sup> *Nedbank* supra note 34 at 23.

or that the company which is now in liquidation had already been under business rescue.<sup>215</sup> Currently there exists no case where a company had been under business rescue and then while in liquidation new facts have arisen to warrant another business rescue application. *Richter v ABSA*<sup>216</sup> provides a nice base from which business rescue jurisprudence can be built from as its approach has opened many doors for the courts to deal with.

The contention in *Richter v ABSA*<sup>217</sup> was that if courts adopt such a liberal approach to business rescue applications then there exists potential for the system to be abused.<sup>218</sup> This submission is warranted and makes sense because our insolvency law has been previously abused by debtors who have used friendly sequestrations as a means of escaping debts and frustrating creditors.<sup>219</sup> The SCA held that while potential for abuse does exist it should not mean a court should use that as a factor to deny business rescue after liquidation and should affected persons abuse the system by bringing frivolous applications then the courts are empowered to make a punitive cost order.<sup>220</sup>

#### 4.2.4 LIQUIDATOR'S AND BUSINESS RESCUE PRACTITIONER'S CLAIMS

When a company in liquidation is placed in business rescue the liquidator becomes a concurrent creditor in business rescue.<sup>221</sup> This consequence has a negative side and a positive side. The negative side is from the perspective of a liquidator, who will have a vote equal to his claim in business rescue. Given that a liquidator's fees are a

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<sup>215</sup> *Nedbank* supra note 34.

<sup>216</sup> *Richter* supra note 11.

<sup>217</sup> *Richter* supra note 11.

<sup>218</sup> *Richter* supra note 11 at 16.

<sup>219</sup> *Mthimkhulu v Rampersad* (2000) 3 ALL SA 512 (N) 514.

<sup>220</sup> *Richter* supra note 11.

<sup>221</sup> *Richter* supra note 11 at 12.

percentage of the gross amount of the estate it is most likely that his voting rights are very small in business rescue. The positive side is from the perspective of the company in financial distress as a company has a useful bargaining tool when it's in liquidation. The study has primarily looked at the value of business rescue as a regime to rescue a company but perhaps for a company that is already in liquidation it can be a useful threat or bargaining tool that can encourage a compromise with creditors. A liquidator represents the creditors interests, but the threat of a business rescue application can quickly force a liquidator to consider where his own fees will come from, especially in the event of a company relying on the second objective of business rescue. Where a company has successfully applied for business rescue and a business rescue plan giving effect to selling off the company assets to achieve a greater return for creditors should send alarm bells to liquidators. Business rescue balances the playing fields and does not allow liquidators to act in a draconian manner and almost forces creditors to bargain before a liquidator incurs further costs of having to defend a business rescue application.

The ranking of claims in business rescue was established in *Merchant West*<sup>222</sup> as follows:

1. The practitioner, for remuneration and expenses, and other persons (including legal and other professionals) for costs of business rescue proceedings.
2. Employees for any remuneration which became due and payable after business rescue proceedings began.

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<sup>222</sup> Supra note 25 at 21.

3. Secured lenders or other creditors for any loan or supply made after business rescue proceedings began, i.e. post-commencement finance.
4. Unsecured lenders or other creditors for any loan or supply made after business rescue proceedings began, i.e. post-commencement finance.
5. Secured lenders or other creditors for any loan or supply made before business rescue proceedings began.
6. Employees for any remuneration which became due and payable before business rescue proceedings began.
7. Unsecured lenders or other creditors for any loan or supply made before business rescue proceedings began.<sup>223</sup>

This does raise concerns for a liquidator who falls under a concurrent creditor, but this situation can quickly change should the company go back into liquidation and business rescue fails. Where a business rescue practitioner has not received his fees in business rescue and the company is back in liquidation he now becomes a concurrent creditor.<sup>224</sup> This balances the playing fields because it motivates liquidators and business rescue practitioners to do their best and they can be seen as being forced to do so because they now both have something to lose. This system means that there is greater room for negotiating and bargaining and allows an atmosphere conducive to compromise and settlements in terms of s155 of the Companies Act 2008.<sup>225</sup> This is why business rescue is not creditor unfriendly because all it creates is a friendlier atmosphere between the stakeholders to a company in liquidation as opposed to a hostile creditor friendly approach that sees a liquidator as a creature of statute

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<sup>223</sup> Ibid

<sup>224</sup> *Diener N.O v Minister of Justice* (926/2016) [2017] ZASCA 180.

<sup>225</sup> Companies Act 71 of 2008: s155.

performing the tasks of getting the company assets and selling it for the benefit of creditors. With the creation of business rescue, liquidators will now be more willing to advise creditors of entering into s155 compromises due to the threat of upcoming business rescue applications that could stall creditors receiving any dividends for a few months.

## CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

Business rescue has proved to be successful for certain companies such as the Moyo Group which was in the restaurant industry.<sup>226</sup> These cases create a better picture of business rescue and its potential in law and economics. The creation of business rescue does not just create a workout for financially distressed companies but also has the potential to inspire a quasi-venture capitalist industry where companies can invest in financially distressed companies or outright buy the company at a discount and pay off the debts and thereafter sell the company for a profit.<sup>227</sup>

This is an indication that the system has worked and if courts adopt a liberal threshold it can work for many other financially distressed companies. One of the concerns is that the economic climate can change very quickly and can be compared to a set of dominoes because when we allow one company in financial distress a period of respite from creditor claims, we can cause those very same creditors to become financially distressed. This is an important principle because business rescue is aimed at empowering South Africa's economy as a whole and if we adopt an approach that becomes too debtor friendly, we may end up in an economy filled with revolving debt.<sup>228</sup> This is why the interpretation of the term 'reasonable prospects' is very important because the need for an equilibrium that balances the rights of all

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<sup>226</sup> Fin 24 'Purchaser Found for Moyo Business Rescue' 2014

<https://www.fin24.com/Companies/Retail/Purchaser-found-for-moyo-business-rescue-20140330>. Accessed on 18<sup>th</sup> October 2018.

<sup>227</sup> ENCA 'Buyers of distressed South African businesses likely to emerge' 2016

<https://www.enca.com/money/buyers-of-distressed-south-african-businesses-likely-to-emerge>. Accessed on 18<sup>th</sup> October 2018.

<sup>228</sup> Companies Act 71 of 2008: s7.

stakeholders is vital for legal certainty and economic growth. The ultimate aim is to establish a test that is pro creditor and pro debtor.<sup>229</sup>

To achieve this test the stigma associated with financial distress and rescuing a company would need to change. There are reasons for creditors to be concerned when a company seeks to be rescued but it may not necessary be a bad thing as an alternative to liquidation. Creditors would need to be on board with business rescue and trust in the system and this is why the system needs to be corrected so there can be legal certainty. This can only take place once chapter 6 has been judicially ironed out so the legal profession can advise both creditors and debtors on what the law prescribes as opposed to having creditor resistance to business rescue and legal practitioners testing the courts to answer questions where there is uncertainty. The two ways this can be done are to let the courts slowly answer and develop Chapter 6 of the Companies Act 2008 or to amend the Act. Given that the duty of creating the law is that of the legislature and that business rescue is definitely going to be a part of South African law for a long time I would recommended that Companies Act 2008 be amended.

Judicial exploration with the term 'reasonable prospects' should not be repeated in business rescue as this term has already been examined. Business rescue is often referred to in case law as being new in South African law, but I disagree. Business rescue might be relatively new in the sense that it was enacted in 2011, but the concept of corporate rescue is not. Furthermore, the uncertainty in South Africa's economy has

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<sup>229</sup> E Levenstein 'An appraisal of the new South African business rescue procedure' (unpublished LLD thesis, University of Pretoria, 2016) 641.

caused an influx of business rescue applications which means the courts are regularly dealing with the provisions of chapter 6 of the Companies Act 2008. Business rescue and the uncertainty regarding 'reasonable prospects' cannot be said to be a new concept anymore as business rescue applications are a frequent visitor in South African courts and have been visiting regularly since its operation. Academics have recommended that special courts should be created to handle business rescue and liquidations, but this is unnecessary because the Companies Act provides that Courts may appoint a specialized judge to preside over business rescue applications.<sup>230</sup>

There is a shift towards a liberal approach by the judiciary but the process of the courts slowly finding its feet is an indication that the framework of chapter 6 was insufficient. The legislature should consider creating a guiding provision that mandates the courts to consider certain factors when tasked with adjudicating business rescue applications. In order to create a workable, pragmatic and liberal test for business rescue the legislature should consider defining the term and/or even mandating courts to consider certain factors when making a determination on reasonable prospects.

I propose the following amendments:

A definition of reasonable prospects as an allegation backed up by facts that if given the chance to materialize may result in one or more of the following objectives of business rescue and includes but is not limited to:

- a) A creditor writing off a substantial claim
- b) The company being awarded a contract
- c) The company securing finance

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<sup>230</sup> Levenstein op cite note 229 at 590.

- d) The company being sold as a going concern

The decision on whether there is a 'reasonable prospects' is a question of law that is inferred from facts. Therefore, it is important that an Applicant display facts to back the allegation that there is a reasonable prospect. The weight attached by a court to these facts can cause uncertainty, therefore a further amendment guiding a court in this enquiry should also be considered by the legislature. A provision such as:

A court when determining reasonable prospects must consider;

- a) the type of company and its size;
- b) the amount of debts outstanding compared against the prospects relied on;
- c) any prejudice to creditors and the degree of such prejudice;
- d) that a business rescue practitioner will conduct a thorough inquiry into reasonable prospects if the application is successful in terms of s141.

The legislature should also consider amending s131 as follows:

~~“Unless a company has adopted a resolution contemplated in section 129, an affected person may apply to a court at any time so long as the company is not already in business rescue for an order placing the company under supervision and commencing business rescue proceedings.”~~

This will remove any ambiguity when interpreting whether a company is capable of being placed in business rescue after it had filed a resolution in terms of s129 and the process had failed, became a nullity or was converted to a liquidation.

The legislature should also consider an amendment specifying who is in control of the company because a lacuna is created by s131(6) where liquidation is suspended by a business rescue application. An amendment should provide for who is in control of the company during the period from when the application is made till the court's decision. The amendment should provide for an independent curator or that the provisional or final liquidators remain in control but may not dispose of any property similar to the way in which an appeal on the final order of liquidation operates that allows a liquidator to conduct his duties but may not dispose of any property in the estate pending the decision by the appeal court.

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