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**INYUVESI  
YAKWAZULU-NATALI**

NTOMBIKHONA THANDEKA XABA

214531874

The effects of business rescue on the companies' stakeholders: A comparative analysis between business rescue and judicial management

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Supervisor: Adv Darren Cavell Subramanien

Ms C Badul

**DECLARATION**

I, Ntombikhona Thandeka Xaba, student number 214 531 874, declare that this thesis is an original piece of work that has been composed solely by myself and that it has not been submitted, in whole or in part, in any previous application for a degree. Except where stated otherwise by reference or acknowledgment, the work presented is entirely my own.

SIGNED BY.....  
AT.....ON THIS.....DAY OF NOVEMBER  
2018.

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## ABSTRACT

Upon the recognition that the implementation of the judicial management process would not be the success that it was anticipated it would be, it became apparent that there was need for a system of corporate rescue appropriate to the needs of a modern South African economy.<sup>1</sup> The legislature then introduced a new business rescue regime when the Companies Act 71 of 2008<sup>2</sup> (the Act) came into effect in the South African law. This new Act remarkably changed corporate law. One of the central features of the Act is the introduction of business rescue- a procedure which provides for the rehabilitation of financially distressed companies in a manner that seeks to balance the rights of all stakeholders.<sup>3</sup> These provisions are said to be the appropriate method for modern South African economy and they differently affect the stakeholders of a company.<sup>4</sup> This thesis will be discussing the different rights given to affected persons in the new Companies Act and examine how the provisions of business rescue affect different stakeholders of the company and compare such effects with those experienced under judicial management, specifically in light of the improvements of the positions of the stakeholders. Although the new business rescue is a remarkable improvement from the old judicial management system, there is still room for improvement.<sup>5</sup>

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<sup>1</sup> *Le Roux Hotel Management (Pty) Ltd & another v E Rand (Pty) Ltd (FBC Fidelity Bank Ltd (under Curatorship), Intervening* 2001 (2) SA 727 (CPD) at 18.

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

<sup>3</sup> Section 7(k) of Act 71 of 2008.

<sup>4</sup> R C Williams *Concise Corporate and Partnership Law* 2ed (1997) 187.

<sup>5</sup> *Ibid* at 186.

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## CHAPTER ONE

### INTRODUCTION

#### I. HISTORICAL BACKGROUND

The concept of rescuing a company means a reorganisation of the company as to restore it to a profitable entity and avoid liquidation.<sup>6</sup> The South African law provisions of rescue procedures can be traced back from the judicial management provisions found in the Companies Act 24 of 1926<sup>7</sup> and the Companies Act 61 of 1973<sup>8</sup> which provide the same procedure under judicial management. The provisions and the implementations of the judicial management as a system of rescuing financially distressed companies has been criticised by many legal experts and thus the need for a new corporate rescue system was necessary in modern South African corporate law.<sup>9</sup> To rectify these failures, the Companies Act 71 of 2008<sup>10</sup> (the Act) was enacted and it came with several amendments to the corporate law of jurisprudence in South Africa. One of the highlighted amendments is the provision of business rescue found in chapter 6 of the Act.

#### II. PROBLEM STATEMENT AND RESEARCH OBJECTIVES

The provision on business rescue is one of the main themes of the Act and this is because of its objectives, which is to provide a rehabilitation of financially distressed companies in a manner that balances the rights of all stakeholders involved.<sup>11</sup>

These provisions are said to be the appropriate method for the modern South African economy and they differently affect the stakeholders of a company. The purpose of this dissertation is to discuss rights given to affected persons in the Act and to examine how the provisions of business rescue affect different stakeholders of the company and compare such effects with those under judicial management.

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<sup>6</sup> FHI Cassim et al *Contemporary Company Law* (2012) 861.

<sup>7</sup> Companies Act 24 of 1926.

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

<sup>9</sup> *Le Roux Hotel Management* supra note 1.

<sup>10</sup> Companies Act 71 of 2008.

<sup>11</sup> Section 7(k) of Act 71 of 2008.

### III. RESEARCH QUESTIONS

This dissertation will seek to answer the questions about the effect of business rescue on the company's stakeholders. The main research question is: whether business rescue proceedings affect different stakeholders of the company? Whether this is advantageous to the stakeholders? In the process of answering the main questions, the following sub-questions will also be answered:

- a) How did the provisions of business rescue in the Act come about?
- b) What are the objectives of this provisions, and the process involved thereof?
- c) Is the scope of company's stakeholders limited to the definition of affected persons?
- d) How does business rescue affect employees and employment contracts of the company?
- e) How does business rescue affect creditors and shareholders of a company?
- f) To what extent does the effect of business rescue on the stakeholders affect the economy of the country?
- g) Are the effects of business rescue on stakeholders and the economy different from the ones experienced under the judicial management?
- h) Can the court use the effects of business rescue under the Act as one of the factors in exercising it discretion whether or not to grant the business rescue application?

### IV. RESEARCH METHODOLOGY

The dissertation will take the form of a qualitative approach with reference to various pieces of legislation in evaluating the underlying issues regarding the impact that business rescue has on the stakeholders of the company. This will be done by including a brief overview of business rescue as a new concept of corporate rescue, followed by the main discussion of the effects of business rescue on different stakeholders; both primary and secondary stakeholders and consequently the economy of the country. The research in this dissertation will comprise a review of the existing literature on this topic, legislation on the subject, and various court judgments. The online database will mostly be used to collect the information, and where necessary hard copy secondary sources will be consulted.

## V. CHAPTER OVERVIEW

This dissertation will take the form of six chapters, each chapter will have an introduction and sub-headings. The summary of the chapters will be as follows;

- Chapter one is the introduction; this chapter introduces the overall topic for this study and how the study is structured.
- Chapter two will discuss the process of business rescue, how does it commence, the requirements for the commencement and the concept of company's stakeholders.
- Chapter three will discuss the creditors of the companies and how they are affected by the provisions and implementation of business rescue process.
- Chapter four will discuss the role of shareholders in business rescue proceedings, this chapter deals with the rights of shareholders as affected person's and will examine to what extent the new corporate rescue allows for their participation and involvement, and whether business rescue will significantly improve the position of shareholders in the corporate rescue regime.
- Chapter five will discuss the employees of the company that is placed under business rescue and how they are affected by the process, what are the rights afforded to employees and examine to what extent the new corporate rescue allows for their participation and involvement. The chapter will consider the provisions of the two pieces of legislations, namely the Act and the Labour Relations Act
- Chapter six, which is the concluding chapter, will be the comparative analysis between the effect of the business rescue and the effect of the judicial management on various stakeholders discussed in previous chapters and an overall conclusion on the topic at hand.

## VI. RATIONALE FOR THE STUDY

The concept of business rescue is a new concept found in the Act<sup>12</sup> as stated above. The concept of business rescue is a novel in our corporate law and there has been limited academic writing about it and thus still requires much attention and analysis to ensure it is understood and interpreted correctly by the courts. The Act has many grey areas which require clarity when it comes to the impact that the provisions have on the stakeholders of the company for an

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<sup>12</sup> *Le Roux Hotel Management* supra note 1.

example, the issue of employment contracts during business rescue. This dissertation will analyse the rights afforded to different stakeholders and the impact of the provisions of the Act on the stakeholder of the company that is placed under business rescue.

The dissertation will also analyse the effect of business rescue on employment contracts, whether these contracts are suspended where business rescue order is granted. In line with this, the dissertation will look at the question whether the business rescue practitioner is obliged to follow the retrenchment procedure provided for in the Labour Relations Act<sup>13</sup> or whether there is a different procedure in the Act. If there is a different procedure, which procedure must be followed by the business rescue practitioner? The dissertation will also consider this issue in light of the employees that are unionised and employees that are not, whether they are treated differently by the provisions of the Act.

The dissertation will indicate that the effect of insolvency of a company is not only limited to those of the insolvent debtor (company) and its creditors, but there are other groups in society that are affected by such insolvency for example the suppliers.<sup>14</sup> This implies that placing a company under business rescue also affects such groups of people. The Act limits the scope of the company's stakeholders to its definition of affected person which only include primary types of stakeholders and not the secondary type including the economy of the country, which also needs to be considered as they are also affected by such provisions.

The effect of the business rescue process on the employees and employment contract is important as it also impact further on the economy of the country and the community as a secondary stakeholder of the company in question and thus the provisions found in the employment law and the Act<sup>15</sup> have to be interpreted in such a way that they bring about positive impact of saving the jobs which is one of the current issues in South Africa, causing poor economic growth.

This dissertation will also analyse the effects that business rescue has on creditors of the company. This need to be clear so that the creditors know how adopting the plan will both benefit and harm them and be able to make a rational decision based on clear facts. The Act is not clear on the issues whether or not creditors lose their claim against a surety if a duly adopted

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<sup>13</sup> Labour Relations Act 66 of 1995.

<sup>14</sup> Cassim op cit note 6 at 861.

<sup>15</sup> Companies Act 71 of 2008.

and implemented business rescue plan provides for the creditor's claim against the principal debtor to be compromised in full and final settlement of such claim. It is important to look at how the courts have interpreted different facts of different cases to fill in the gap that was left open by the legislature and to look into whether such interpretations adopted by the court are considerate to the interests of both parties which are creditor and debtor in such a conflict.

The dissertation will also discuss one of the purposes of the Act which is a better return for creditors and how the courts have interpreted its implications to the provisions of business rescue. The appointment of a business rescue practitioner and how it affects the contribution of creditors and consequently the economic growth of the country will also be discussed by the paper. Shareholders have been given limited voting rights where the proposed business rescue does not affect them, whereas they still have financial interest and the implications of such limitation will be discussed in the dissertation. The dissertation will conclude by comparing the effect of business rescue found under the Act and those that were experienced under the provisions of the old Act<sup>16</sup> and thereafter assess whether the Act has improved in anyway.

Business rescue is a very topical issue not only in South Africa but globally. Any study surrounding such a topic is significant and will prove to be a worthwhile intellectual experience as it will contribute towards the correct implementation of the provisions of the Act and will enrich the knowledge of the stakeholders on the issue of business rescue.

## VII. LITERATURE REVIEW

Business rescue is a new corporate rescue structure in South Africa that was introduced in the Companies Act 71 of 2008.<sup>17</sup> The object of business rescue is to keep companies alive and prolong the benefits that its various stakeholders may receive from it and, also to align South Africa's rescue procedures with those of international jurisdictions such as United States of America, United Kingdom and Australia.<sup>18</sup> The Act was drafted with certain expressed objectives to ensure an efficient business rescue process that would facilitate the rescue and

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<sup>16</sup>Companies Act 61 of 1973.

<sup>17</sup> EP Joubert "Reasonable possibility" versus "Reasonable prospect": Did business rescue succeed in creating a better test than judicial management? (2013) 76 *THRHR* 556.

<sup>18</sup> *Ibid.*

rehabilitation of business entity in financial difficulty in a way that would secure and balance the opposing interest of directors, shareholders and employees.<sup>19</sup>

Business rescue has been an alternative to liquidation of several well-known entities in South Africa.<sup>20</sup> A successful business rescue is likely to have an impact on the various stakeholders such as creditors, employees and customers.<sup>21</sup>

Joubert's understanding of the company's stakeholders is limited to the definition of affected persons found in the Act,<sup>22</sup> whereas Conradies and Lamprecht also include customers as one of the stakeholders as well.<sup>23</sup> Both these interpretations are a limited understanding of the company's stakeholders as they include primary stakeholders of the company and only mentioned one example of a secondary stakeholder. The effect of business rescue on the company's primary stakeholders further impacts on the secondary stakeholders and this needs to be discussed as it would likely impact on the court decision whether to grant or reject business rescue application.

Cassim<sup>24</sup> provides a wider range of stakeholders and not just affected persons as listed in the Act. He argues that the effect of the insolvency of the company is not only limited to those of the private interest of the insolvent debtor and his or her creditors, but there are other groups in society that are also affected by such insolvency. The list includes shareholders, suppliers, employees and the customers. This implies that placing a company under business rescue does not affect those groups listed as affected persons but other groups such as customers, suppliers and the economy of the country.

South Africa has often been described as a creditor- friendly jurisdiction that favours the secured creditor. The question then is whether the new business rescue provisions have rectified this shortcoming. In a typical liquidation, secured creditors (usually the banks are paid out up to the value of their security, lawyers and liquidators are paid their fees, SARS gets its amount for tax, as might the employees and then the concurrent creditors are left with a few amount in the rand if anything at all. The new business rescue seeks to change all of this by re-

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<sup>19</sup> Section 7(k) of Act 71 of 2008.

<sup>20</sup> B Wassman 'Business Rescue -Getting it right' (2014) *De Rebus* 40.

<sup>21</sup> S Conradies & C Lamprecht 'Business rescue: How can its success be evaluated at a company level?' (2015) 19(3) *Southern African Business Review* 30.

<sup>22</sup> Joubert op cit note 17.

<sup>23</sup> Conradies & Lamprecht op cit note 19.

<sup>24</sup> Cassim op cit note 6 at 861.

aligning certain rights.<sup>25</sup> However, the provisions of the new Act are still not clear on the issues whether or not creditors lose their claim against a surety if a duly adopted and implemented business rescue plan provides for the creditor's claim against the principal debtor to be compromised in full and final settlement of such claim.

The courts in their interpretation of the provisions of business rescue seem to have placed much weight on the interests of creditors and employees as opposed to the interests of shareholders. When faced with the issue of weighing the interests of creditors and the interest of company, the court in *Oakdene*<sup>26</sup> and *Beagles Run*<sup>27</sup> decided that the interests of the creditors should carry the day. In the Australian decision of *Dallinger v Halcha Holdings (Dallinger)*<sup>28</sup> the implication was that the second goal emphasizes the interest of the company's creditors above its shareholders.

While a business-rescue practitioner does not have the power to cancel securities, he or she can suspend their realisation until the business is either saved or goes into liquidation. In addition to this, it is, in my view, unclear whether a business-rescue practitioner can continue to utilise an asset over which a creditor holds security. While the asset in question cannot easily be sold, the Act is silent as to whether it can be used. If the answer to this is in the affirmative, then the creditor in question may also be faced with the prospect of its security deteriorating during the operation of the business rescue<sup>29</sup>

A business rescue, by its nature and inherent complexity, is likely to be expensive. Most liquidation processes in this jurisdiction are of businesses with very small asset bases. Business rescue cannot work unless there is adequate funding in place, which means that it is not an appropriate route for all distressed companies to follow. If employees and creditors are not aware of their rights and when to exercise them, they will abuse the provisions of the Act and applied for business rescue where it is not possible for such a business to be rescued.

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<sup>25</sup> L Kahn 'Business rescue: Panacea or poison pill? 2010 (3) *Business Tax and Company Law Quarterly* 20.

<sup>26</sup> *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd*. (609/2012) [2013] ZASCA 68 (27 May 2013)

<sup>27</sup> *Swart v Beagles Run Investments 25 (Pty) Ltd* 2011 5 SA 422 (GNP).

<sup>28</sup> *Dallinger v Halcha Holdings* (1994) 14 ACLC 236.

<sup>29</sup> L Kahn op cit note 25 at 23.

## CHAPTER TWO

### PROCESS OF BUSINESS RESCUE

#### I. INTRODUCTION

The concept of business rescue in South Africa was introduced in the Act,<sup>30</sup> which came as a result of failure witnessed under the judicial management as a rescue system. Section 128 (1) (b)<sup>31</sup> describes business rescue as proceeding to facilitate the rehabilitation of a company that is financially distressed by providing a temporary supervision of the company and its management, a temporary moratorium on claims against the company and the development, approval and implementation of a rescue plan. The aim of facilitating this process is to ensure that a company continues to exist as a going concern or, if that is not possible, to result in a better return for company's creditors or shareholders than would from the immediate liquidation of the company.<sup>32</sup> The provisions of business rescue found in chapter 6 of the Act are drafted with clear and expressed objectives which give effect to one of the purposes of business rescue stipulated in the Act, which is to provide for the efficient rescue and recovery of financially distressed companies in a manner that balances the rights and interests of all relevant stakeholders.<sup>33</sup>

Business rescue keeps companies alive and prolongs the benefits to the stakeholders and it has been an alternative to liquidation for several well-known entities in South Africa.<sup>34</sup> In *Gormley v West City Precinct Properties (Pty) Ltd & Another*<sup>35</sup> the court held that business rescue has an aim to facilitate the rehabilitation of a financially distressed company as provided for in s128 (1) (b). It held that the intention of the legislature is to prevent the negative impact on economic and social affairs by rescuing companies rather than liquidating them. Thus, this intention brings in the economy of the country as a secondary stakeholder affected by the business rescue proceedings.<sup>36</sup>

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<sup>30</sup> Act 71 of 2008.

<sup>31</sup> Section 128 (1) (b) of Act 71 of 2008.

<sup>32</sup> Ibid.

<sup>33</sup> Section 7 (k) of Act 71 of 2008.

<sup>34</sup> B Wassman op cit note 20.

<sup>35</sup> *Gormley v West City Precinct Properties (Pty) Ltd & another; Anglo Irish Corporation v West City Precinct Properties (Pty) Ltd & another* [19075/11, 15584/11] [2012] ZAWCHC 33 (18 April 2012) at 11.

<sup>36</sup> Ibid.

The aim of this chapter is to identify and discuss the circumstances under which the application for business rescue proceedings may be ordered by discussing the preconditions found in both s129 and s131 of the Act (financially distressed, failure to pay any amount, just and equitable and reasonable prospect of rescuing a company) and the court interpretation of such preconditions. This is important because these are the early stages where the rights of different stakeholders start to be affected.

## II. METHODS OF COMMENCING THE BUSINESS RESCUE PROCESS

There are two methods in which a company can commence business rescue proceedings; these are stipulated in the Act.<sup>37</sup> The first method is through a resolution by the company's board of directors which is a voluntary business rescue.<sup>38</sup> The second method is a compulsory method which is a court order for a company to start business rescue proceedings.<sup>39</sup> According to s129 (1) the board of directors may resolve that the company voluntarily begins business rescue proceedings and place the company under supervision, if the board has reasonable ground to believe that –

- ‘(a) the company is financially distressed, and
- (b) there appears to be a reasonable prospect of rescuing the company.

The preconditions set out in s131 also require that the affected person who applies for business rescue may be granted such an order if the court is satisfied that-

- (i) the company is financially distressed;
- (ii) the company has failed to pay over any amount in terms of an obligation under or in terms of a public regulations or contract, with respect to employment related matters; or
- (iii) it is otherwise just and equitable to do so for financial reasons, and there is a reasonable prospect of rescuing the company’.<sup>40</sup>

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<sup>37</sup> Act 71 of 2008.

<sup>38</sup> Section 129 of Act 71 of 2008.

<sup>39</sup> Section 131 of Act 71 of 2008.

<sup>40</sup> Section 131(4) of Act 71 of 2008.

### III. REQUIREMENTS FOR BUSINESS RESCUE PROCEEDINGS

#### *(a) Financial distress*

This is a precondition that needs to be satisfied in both voluntary and compulsory application of business rescue. According to s128(1) a company is financially distressed if at any particular time it appears to be either reasonably unlikely that the company will be able to pay all its debts as they become due within the immediate ensuing six months, or reasonably likely that the company will become insolvent within the next six months.<sup>41</sup> Where there is an application made to the court by an affected person in terms of s131 (4), the Act provides for two other alternatives for the requirement of financially distressed.<sup>42</sup> Before discussing these alternative requirements it is important to consider the difficulties or the implications of the requirement 'financially distressed'. This element is not easy to prove, especially for outsiders who cannot predict the future of the company's performance without access to company records.<sup>43</sup>

Another difficulty with this provision is that it does not distinguish between the sizes of the companies when it comes to the period for such a company to be considered as being financially distressed. It merely assigns a period of six months to both big and small companies. The rationale for such a limitation however was stated by the court in the case of *Gormley v West City Precinct Properties (Pty) Ltd & Another*<sup>44</sup> where the court held that business rescue is meant to be a short-term approach and that this is so for self-evident reasons that there must be a measure of certainty in the commercial world. Creditors cannot be left in a state of flux for an indefinite period.<sup>45</sup> On the facts this case, the court found the company in question to be so insolvent that it did not fall within the definition of financially distressed. The business rescue application was dismissed, and the company was placed under provisional liquidation.

Section 5 (1) of the Act<sup>46</sup> requires that the Act be interpreted and be applied in a manner that gives effect to the purpose set out in s7 and regarding the objectives of the business rescue

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<sup>41</sup> Section 128 (1) (f) (i) - (ii) of Act 71 of 2008.

<sup>42</sup> A Loubser 'The business rescue proceedings in the companies Act 71 of 2008: Concerns and Questions (Part1) (2010) 3 *TSAR* 512.

<sup>43</sup> R Bradstreet 'The wolf in sheep's clothing- when debtor-friendly is creditor friendly: South Africa's business rescue and alternatives learned from United State Chapter 11' (2015) 2 *JCCL&P* 1, 22.

<sup>44</sup> *Gormley* supra note 35.

<sup>45</sup> *Gormley* supra not 35 at 13.

<sup>46</sup> Section 5 (1) of Act 71 of 2008.

proceedings. In *Tyre Corporational Cape Town v GT Logistics (Pty) ltd & Others*<sup>47</sup> an application for liquidation of the company was opposed by the application of business rescue. The applicant raised an argument against business rescue and submitted that the current insolvency of a company is an absolute bar to granting a business rescue application in favour of that company.<sup>48</sup> The applicant further argued that this company was not only commercially insolvent (not able to pay its debts) but it was factually insolvent also (its liabilities exceed its debts). The applicant relied on the judgement of *Merchant West Working Capital Solution (Pty) ltd v Advanced Technologies & Engineering Company (Pty) ltd & Another*<sup>49</sup> which held that it is clear from the definition of financially distressed that a company could not be placed in business rescue if it was already insolvent.

However, Rogers J in this case opposed the submission and held that the definition of 'financially distressed' in s128 (1) creates a threshold.<sup>50</sup> It was further held that current commercial or factual insolvency is not a prerequisite; it does not follow that because the company is commercially or factually insolvent and thus financially distressed, it could no longer be placed in business rescue. The court in this case held that such an interpretation would be inconsistent with s5 (1) read with s7 of the Act, since it would oblige the court to order a liquidation of a company even though there might be a reasonable prospect of rescuing it. The court held that according to the definition of 'financially distressed' found in the Act, the legislature seems to refer to commercial insolvency rather than factual insolvency.<sup>51</sup>

This is important as it encourages companies to use the proceeding of business rescue at the first sign of financial difficulty and gives them alternative prior to factual insolvency. This was confirmed by the court in the case of *Welman v Marcelle prop*<sup>52</sup> where the court held that business rescue is not for terminally ill close corporations, nor are they for chronically ill ones, they are for ailing corporations which given time will be rescued and become solvent.<sup>53</sup> This statement supports the contention made that at first sign of financial distress, a company should

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<sup>47</sup> *Tyre Corporational Cape Town (Pty) ltd & others v GT Logistics (Pty) ltd & others* (2017) JOL 38055 WWC at 249

<sup>48</sup> *Ibid*

<sup>49</sup> *Merchant West Working Capital Solution (Pty) ltd v Advanced Technologies & Engineering Company (Pty) ltd & another* (2013) ZAGPPHC 109 (10 May 2013) at 8.

<sup>50</sup> *Tyre Corporational Cape Town (Pty) ltd & others* supra 47 at 253

<sup>51</sup> *Gormley* supra note 35 at 15.

<sup>52</sup> *Welman v Marcelle Props* 193 CC (2013) ZAGPJHC at 32.

<sup>53</sup> *Ibid*.

apply for business rescue. Once a company is more financially distressed options other than business rescue become more attractive for ailing company such as liquidation or compromise.

The dissertation will now look at the two alternatives provided by the Act in case of application by affected persons.

*(b) Failure to pay any amount*

As an alternative to the ‘financial distress’ requirement, an applicant may apply for a business rescue order relying on non-payment of amounts due in respect of contractual or statutory obligations relating to employment matters.<sup>54</sup> This requirement is designed to protect employee creditors specifically in that proving a mere breach of an employment contract would be sufficient ground to obtain a business rescue order when there is also a reasonable prospect of success.<sup>55</sup> Thus, employees and trade unions are afforded equal rights as creditors to commence business rescue.<sup>56</sup> The difficulty with this requirement would be that employees can rely on this provision even if one payment is missed, which could be as a result of administration or system failure by the company or its bank, or other reasons not indicative of or related to financial difficulties.<sup>57</sup> Loubser submits that non-payment should occur over a stipulated minimum period or frequently before it can constitute a ground for rescue proceedings, and at least two consecutive payments should be missed.<sup>58</sup>

The legislature has opened a floodgate of abuse of business rescue by granting the right of application to individual employees and not setting out the minimum period of the failure to pay the employee the amount due. The Act should have stated how long the company should fail to pay, so there is a need for amendment or addition of some provisions in the Act. The issue was considered by the court in *Nedbank Ltd v Bestvest 153 (Pty) Ltd & Others*<sup>59</sup> where there were two applications to the court, the first was an application to wind up and the second was an application for business rescue.<sup>60</sup> The facts were that Bestvest owned a valuable piece of commercial property in Cape Town, it developed the property and erected a building thereon borrowing money for that purpose from Nedbank. Bestvest later experienced financial

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<sup>54</sup> Section 131 (4) (a) (ii) of Act 71 of 2008.

<sup>55</sup> Bradstreet op cit note 43.

<sup>56</sup> Bradstreet op cit note 43 at 24.

<sup>57</sup> Loubser op cit note 42 at 512.

<sup>58</sup> Ibid.

<sup>59</sup> *Nedbank Ltd v Bestvest 153 (Pty) Ltd & others* 2012 (5) SA 497 (WCC).

<sup>60</sup> Ibid at 10.

difficulties which resulted in it not meeting its repayment obligations. Eventually, Nedbank launched for the proceedings for the winding up of the company based on its indebtedness.<sup>61</sup>

However, the directors of the company believed that the company could still be saved from insolvency by appointment of a business rescue practitioner and by it applying for business rescue proceedings.<sup>62</sup> The court looked at two jurisdictional facts in exercising its wide discretion as to whether business rescue should be granted, these were financial distress and reasonable prospect.<sup>63</sup> The court held that there was no reasonable prospect of the company being rescued by the appointment of a business rescue practitioner nor was it just and equitable to do so for financial reasons. Thus, the court ordered the winding up of the company.<sup>64</sup> In effect the court's judgement was that a failure to pay an amount due means that the company is insolvent.

*(c) Just and equitable to do so*

The requirement of just and equitable is also considered as the second alternative ground replacing a financial distressed company under business rescue. The phrase 'just and equitable for financial reasons' is very vague and it not clear whether those financial reasons must be related to financial difficulties that are not covered by the definition of financial distressed, such as a company may become insolvent or unable to pay its debts over a longer time than stipulated in the definition.<sup>65</sup> However, the court in *Oakdene Square Properties (Pty) Ltd & others v Farm Bothasfontein (Kyalami) (Pty) Ltd & others*<sup>66</sup> attempted to provide a guideline at what is meant by financial reasons. It held that financial reasons ought to relate to the stakeholders. Therefore, a court may exercise its discretion and order that business rescue proceeding be commenced with as they will be just and equitable, where the affected party is able to show that the proceedings will not only benefit the company but also shareholders and creditors and other interested parties.<sup>67</sup>

This requirement could be used by the employees and shareholders who believe that because of current mismanagement of the company, it is likely to fail over the longer term. This

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<sup>61</sup> *Nedbank Ltd* op cit at 15.

<sup>62</sup> *Ibid* at 7.

<sup>63</sup> *Ibid* at 27-28.

<sup>64</sup> *Nedbank* supra note 49 at 63.

<sup>65</sup> Loubser op cit note 42 at 512.

<sup>66</sup> *Oakdene Square Properties (Pty) Ltd & others v Farm Bothasfontein (Kyalami) (Pty) Ltd & others* 2012 (3) SA 237 (GSJ).

<sup>67</sup> *Ibid* at 20.

provision will lead to interpretational problems based on its vagueness and should preferably be removed.<sup>68</sup> Bradstreet's<sup>69</sup> interpretation of the phrase 'otherwise just and equitable to so for financial reasons' is somewhat mysterious. The author of Henochberg notes that the term financially distressed already covers the financial reasons for wanting to place a company under business rescue and it is difficult to think of any other circumstances where this would otherwise be the case.<sup>70</sup> Loubser suggests that this difficulty could be solved by broadening the definition of financially distressed to include circumstances in which a company will be deemed to be financial distressed.<sup>71</sup>

*(d) Reasonable prospect of rescuing a company*

The board of directors of a company may resolve that the company voluntarily begins business rescue proceedings and place a company under supervision, if the board has reasonable grounds to believe that the company is financially distressed and there appears to be a reasonable prospect of rescuing the company.<sup>72</sup> This provision of the Act does not require the applicant to prove a reasonable probability of success in rescuing the company as was required by the judicial management system, but the applicant now needs to prove that there appears to be a reasonable prospect of rescuing the company in terms of s129 of the Act.<sup>73</sup>

The requirement of proving reasonable probability under judicial management is said to be one of the contributory factors towards its failure as a rescue procedure, it is described by other authors as a cumbersome and ineffective procedure because of the high threshold of proof required. Chapter 6 of the Act uses the term reasonable prospect as a burden of proof for an order of business rescue to be granted. The phrase 'reasonable prospect' is however not defined in both s1 and s128 of the Act. The dictionary meaning of the word prospect means the possibility or likelihood of some future event occurring.<sup>74</sup> Whereas the old Act requires possibility, which is the extent to which something is probably (likely to happen or be the case).<sup>75</sup>

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<sup>68</sup> Loubser op cit note 42 at 512.

<sup>69</sup> Bradstreet op cit note 43 at 21.

<sup>70</sup> Bradstreet op cit note 43 at 21

<sup>71</sup> Loubser op cit note 42 at 514.

<sup>72</sup> Section 129 (1) (a) - (b) of Act 71 of 2008.

<sup>73</sup> Section 129 (1) (a) - (b) of Act 71 of 2008.

<sup>74</sup> Joubert op cit note 17 at 552

<sup>75</sup> Joubert op cit note 17 at 553.

As the Act does not provide the definition of the phrase ‘reasonable prospect’ we turn to case law for an interpretation and clarity on this issue. One of the important judgments dealing with the interpretation of reasonable prospect is the case of *Southern Palace Investment 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd*.<sup>76</sup>In this case, one of the parties, *Zoneska (Pty) Ltd* launched an application for compulsory winding up of the respondent’s (Midnight Storm Investment 386 Ltd) business because of its inability to pay its debts. The respondent’s indebtedness to Zoneska arose from a loan agreement. Subsequently, the applicant in this case (Southern Palace investment 256 (Pty) Ltd) brought an application for business rescue proceedings to be commenced in respect of the respondent in terms of the provisions of s131(1) of the Companies Act.<sup>77</sup> The applicant for business rescue relied on the claim it acquired against the respondent from another creditor and it therefore qualified as an affected person and has locus standi in terms s128(1) (a) (i) of the Act. The court had to decide what the appropriate order would be, in order to do this the court started by assessing whether the requirements for business rescue as set out in s131(4) were satisfied.<sup>78</sup>

With regards to the requirement of reasonable prospect, the court held that the use of this term in the new Act rather than the reasonable probability required under judicial management indicates that something less is required.<sup>79</sup> The approach in the new business rescue proceeding is the opposite approach compared to the one under judicial management in that it prefers business rescue over liquidation. However, the court still has the discretion not to grant business rescue.<sup>80</sup>The court held that in order to determine reasonable prospect of rescuing the company, one would have to consider the following factors: the cause of the failure of the company’s business; and a remedy offered to address the cause of failure, which has the reasonable prospect of being sustained.<sup>81</sup> This remedy should include: costs required for a company to resume its core business; availability of necessary cash resources; availability of other necessary resources and reasons why the proposed business rescue plan will have a reasonable prospect of success. The court then concluded by looking to the facts of the case at

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<sup>76</sup> *Southern Palace Investment 265 (Pty) Ltd v Midnight Storm investments 386 Ltd* 2012 (2) SA 423 (WCC) at 20.

<sup>77</sup> *Ibid* at 17

<sup>78</sup> *Ibid* at 19.

<sup>79</sup> *Ibid* at 21.

<sup>80</sup> *Ibid* at 22.

<sup>81</sup> *Southern Palace Investment* supra note 62 at 23.

hand and held that there was no reason to believe that there is any prospect of the business of the respondent being restored to be a successful one.<sup>82</sup>

In the case of *Prospect Investment (Pty) Ltd*<sup>83</sup> the court held that a prospect means an expectation which signifies a possibility.<sup>84</sup> A possibility is in turn reasonable if it rests on the ground that is objectively reasonable. A mere speculative suggestion is not enough. In *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd*,<sup>85</sup> Farm Bothasfontein (Kyalami) (Pty) Ltd ('the company') was in default on payments to certain creditors, facing imminent liquidation, the company launched a business rescue application. This application was opposed by Imperial Holdings Ltd and Nedbank Ltd the majority shareholders in the company as a result of past financing transactions. Nedbank and Imperial Holdings Limited each held 30 percent of shares of the company and were therefore affected persons by virtue of their shareholdings as well as being creditors of the company. Nedbank and Imperial opposed the business rescue application on the simple basis that any proposal put forward by the practitioner will be rejected as, having 60 percent of the vote, they will vote against it.<sup>86</sup> The court was thus faced with the question whether to allow access to business rescue proceedings for ensuring a better return for the company's creditors than might be provided by liquidation proceedings.<sup>87</sup> This application for compulsory business rescue was brought made in terms of section 131 of Act 71 of 2008.<sup>88</sup>

Even though it was common cause that the company in question was financially distressed as defined in section 128(1) the court also dealt with the meaning of the phrase reasonable prospect.<sup>89</sup> It held that something less is required in terms of the Act<sup>90</sup> than was the case in the 1913 Act. The court further stated that if facts were present that showed that there can be a reasonable possibility of rescuing the company, the court might use its discretion and grant the application.<sup>91</sup> In light of the circumstances of the case, particularly that there was no reasonable prospect of rescue, no facts were placed before the court by the applicant in support of its

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<sup>82</sup>Ibid.

<sup>83</sup> *Prospect Investment (Pty) Ltd v Pacific Coast Investment 97Ltd & another* 2013 (1) 542 (FSB).

<sup>84</sup> Ibid at 250.

<sup>85</sup> *Oakdene Square Properties* supra note 54 at 21.

<sup>86</sup> *Oakdene Square Properties* supra note 54 at 11.

<sup>87</sup> *Oakdene Square Properties* supra note 54 at 12.

<sup>88</sup> *Oakdene Square Properties* supra note 54 at 15.

<sup>89</sup> *Oakdene Square Properties* supra note 54 at 15.

<sup>90</sup> Act 71 of 2008.

<sup>91</sup> *Oakdene Square Properties* supra note 54 at 34.

argument in this case. It accordingly failed to show that business rescue would yield a better return for the company's creditors. The court thus dismissed the application for business rescue.<sup>92</sup>

The case of *Employees Solar Spectrum Trading 83 (Pty) Ltd v Afgri Operations Ltd & Solar Spectrum Trading 83 (Pty) Ltd*<sup>93</sup> is the first case dealing with employees since the inception of the new business rescue procedure, employees approached the court as affected persons to apply for a company's compulsory business rescue.<sup>94</sup> The dispute concerned the question whether there was a reasonable prospect to rescue the company. In his judgment Kollapen J referred to the words of Eloff AJ in *Southern Palace* and stated that each case must be evaluated on its own merits, he added that the type of information that is brought before the court by an affected party will depend on the position the specific affected party has toward the company. This was aptly referred to by the judge as a 'balancing exercise'.<sup>95</sup>

In his explanation of the meaning of the word 'prospect' Kollapen J referred to the uncertain nature of the word.<sup>96</sup> He explained it as follows: 'By its very nature a prospect is future looking and dependent upon a number of variables and includes a level of risk to the extent that the future is hardly capable of accurate prediction.'<sup>97</sup> He concluded that what is required is 'a determination that the future prospects of rescuing the business appear to be reasonable'.<sup>98</sup> He then found that in this case the employees indeed made out a reasonable prospect that the business may be rescued and granted the application.<sup>99</sup>

#### IV. CONCLUSION

It is clear from the discussion above that for a court to grant business rescue application the affected person has to show that one of the three requirements set out in s131 (4)<sup>100</sup> exist in terms of that company: the company is financially distressed, the company failed to pay the amount, it would be just and equitable to do so for financial reasons and there is a reasonable prospect that the company can be rescued. Although there are some difficulties experienced in

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<sup>92</sup> *Oakdene Square Properties* supra note 54 at 34

<sup>93</sup> *Employees Solar Spectrum Trading 83 (Pty) Ltd v Afgri Operations Ltd & Solar Spectrum Trading 83 (Pty) Ltd* unreported case no 6418/2011, 18624/2011 and 66226/2011 (NGC).

<sup>94</sup> *Ibid* at 7.

<sup>95</sup> *Ibid* at 14.

<sup>96</sup> *Ibid* at 14.

<sup>97</sup> *Ibid* at 14.

<sup>98</sup> *Ibid* at 33.

<sup>99</sup> *Ibid* at 39.

<sup>100</sup> Section 131 (4) of Act 71 of 2008.

proving the requirements of financially distressed, failure to pay the amount and just and equitable to do so in the circumstance. Proving reasonable prospect remains the single most problematic factor that stands in the way of the granting of business rescue orders, because of the uncertainty experienced by the courts regarding the meaning of the phrase.

It is submitted that one major reason for this uncertainty is the high bar that has been set by Eloff AJ in *Southern Palace Investment 265 (Pty) Ltd v Midnight Storm investments 386 Ltd*.<sup>101</sup> Since then, every decision dealing with a business rescue application where it was common cause that the company was financially distressed, and the issue involved was whether there was a reasonable prospect that the company can be rescued, the guidelines as discussed by Eloff AJ were referred to. The reference made by Eloff AJ to the business rescue plan at that early commencement stage seems to have stuck in the minds of almost all later judges and that resulted in a threshold that is too high. A similar high threshold, even though not exactly the same, caused judicial management to fail as a successful corporate rescue mechanism.

As much as the legislature has tried to lessen the test by stating that reasonable prospect is required rather than reasonable probability, the affected persons still find difficulties in satisfying the court of this requirement. The court themselves are not clear on what the standard should be when determining this requirement. It is submitted that the reasonableness approach that was started by Van der Merwe J in the *Prospec* decision<sup>102</sup> and confirmed in the appeal case can be seen as a constructive approach too many difficulties encountered in proving the recovery requirement. Thus, the provisions of the Act<sup>103</sup> seem to have some degree of uncertainty and gaps which might bring back the same failure that the rescue system encountered under judicial management if they are not rectified in this early stage.

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<sup>101</sup> *Southern Palace Investment 265 (Pty) Ltd* supra note 62.

<sup>102</sup> *Prospec Investment* supra note 67.

<sup>103</sup> Act 71 of 2008.

## CHAPTER THREE

### EFFECT OF BUSINESS RESCUE ON CREDITORS

#### I. INTRODUCTION

Creditors are one of the most important primary stakeholders of a company who get affected by the financial instability of the company. Either the company is insolvent, needing to consequently be wound up, or the application for business rescue is launched on behalf of the company. As stated in previous chapters, creditors make up a group of one of the affected persons that are explicitly mentioned in the Act <sup>104</sup> and they are given powers to participate in the rescue procedures.<sup>105</sup> By allowing creditors to initiate the business rescue themselves, the Act provides an opportunity to take full advantage of the protection that chapter 6 of the Act affords them.

However, the new corporate rescue system, unlike the liquidation process and the previous system of judicial management which have disproportionately protected creditors more than other stakeholders, shifts its primary focus from the interests of the creditors to a broader range of interests.<sup>106</sup> This shift raises some concerns to creditors about the protection of their interests in the company during business rescue proceedings.<sup>107</sup> The Act contains various provisions which affect the rights of creditors of a company undergoing business rescue. Thus, this chapter will look at these rights and how they are affected by the provisions found under chapter 6 of the Act.

#### II. MORATORIUM

When one considers the rights given to creditors in business rescue one must bear in mind that, first and foremost, the commencement of supervision results in the immediate curtailment of the rights of creditors. This is so because once a company has been placed under supervision there comes into force a general moratorium on the institution of legal proceedings against the said company.<sup>108</sup> The effect is to give the business rescue practitioner and, where appropriate, the directors, an opportunity to develop and implement a business rescue plan, whilst the

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<sup>104</sup> Section 128(1) (a) of Act 71 of 2008.

<sup>105</sup> Section 145 of Act 71 of 2008.

<sup>106</sup> Bradstreet *op cit* note 41 at 356

<sup>107</sup> R Bradstreet 'The new business rescue: will creditors sink or swim?' (2011) 128 *SALJ* 352.

<sup>108</sup> Section 133 of Act 71 of 2008.

company's operations continue, without the threat of action by creditors to enforce their rights. In addition, to ensure that the company's assets are not disposed of inappropriately during the proceedings, the Act contains restrictions against disposals, subject to certain consents and exceptions.<sup>109</sup>

The effect of this moratorium is that no enforcement action may be taken against the company unless it is done with the consent of the practitioner or with leave from the court.<sup>110</sup> Furthermore, for the duration of the supervision no guarantees or sureties will be enforceable against the company unless leave is granted by the court.<sup>111</sup> Prescription (or any other time limit imposed on a claim) will not run for the duration of the supervision.<sup>112</sup> For this curtailment, the legislature has granted creditors rights which enable them to play a central role in the business rescue process.<sup>113</sup> Although the moratorium is a blatant infringement on the rights of creditors, it is essential to achieve financial stability. If claims against a financially distressed company were allowed during the process, then the business rescue proceedings would be a fruitless effort.<sup>114</sup>

The Supreme Court of Appeal (SCA) in the recent judgment of *Cloete Murray & another NNO v FirstRand Bank Ltd t/a Wesbank*<sup>115</sup> acknowledged that 'a moratorium on legal proceedings against a company under business rescue, is of cardinal importance since it provides the crucial breathing space or a period of respite to enable a company to restructure its affairs.'<sup>116</sup> The court in this case was faced with the issue of determining the proper meaning of s 133(1), particularly the correct interpretation of the term '... no legal proceeding, including enforcement action, against a company under business rescue may be commenced.'<sup>117</sup>

It was argued that a cancellation of an agreement by the creditor constituted an 'enforcement action' as meant in s 133(1) by the liquidators and thus the absence of the written consent by the business practitioner or leave of the court meant that the cancellation was of no force or

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<sup>109</sup> Section 134(1)-(3) of Act 71 of 2008.

<sup>110</sup> Section 133 (1) (a) and (b) of Act 71 of 2008.

<sup>111</sup> Section 133 (2) of Act 71 of 2008.

<sup>112</sup> Section 133(3) of Act 71 of 2008.

<sup>113</sup> Bradstreet op cit note 107 at 356.

<sup>114</sup> T Silwange *Affected Persons in Business Rescue Proceedings: Has a Balance Been Struck?* (unpublished LLM thesis, University of Kwazulu-Natal, 2017) 11.

<sup>115</sup> *Cloete Murray & another NNO v FirstRand Bank Ltd t/a Wesbank* 2015 (3) SA 438 (SCA).

<sup>116</sup> *Ibid* at 14.

<sup>117</sup> *Ibid* at 28.

effect.<sup>118</sup> After considering the wording of the section, Fourier AJA held that ‘the concepts of ‘enforcement’ and ‘cancellation’ are traditionally regarded as mutually exclusive. ‘Cancellation’ means the termination of obligations between parties to an agreement and cannot be interpreted to mean enforcement action as envisaged under s133 (1)’<sup>119</sup> This means a creditor of the company may cancel an agreement if such company is in breach of the contract, it will not according to s 133(1) be regarded as an enforcement action falling under the notion of moratorium.

In *Chetty v Hart*<sup>120</sup> the court was faced with the question of whether an arbitration proceeding while a distressed company is under supervisor constituted ‘legal proceedings’.<sup>121</sup> It was held that in terms of s133 (1)<sup>122</sup> of the Act, the moratorium on a company did not affect the arbitrator’s jurisdiction to adjudicate a claim where one of the parties was in business rescue. In this case, one party had applied to court in attempt to have an arbitration order set aside contending that it is invalid because the company had commenced business rescue proceedings when such arbitration award was made.<sup>123</sup> This decision by the Supreme Court Appeal (SCA) gives creditors hope because it shows that courts are not prepared to apply s131 (1) loosely and they will not allow this section to be used as scapegoat of the company’s obligations during business rescue.

### III. GENERAL PARTICIPATION RIGHTS GIVEN TO CREDITORS

As it has been already highlighted above, creditors are one of the affected persons explicitly mentioned in the Act<sup>124</sup> their interests are recognized and their participation in the development and approval of a business rescue plan is extensively provided for. Some of the rights given to creditors include the right to participate in court proceedings and discussions on the business rescue plan and to vote on the plan.<sup>125</sup> Business rescue should also generally be attractive to

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<sup>118</sup> Ibid at 24.

<sup>119</sup> Ibid at 33.

<sup>120</sup> B Van Niekerk ‘Chetty v Hart (SCA) (unreported case no 20323/2014, 4-9-2015) (Cachalia JA); ‘Beware the double-edged sword in litigation with a company in business rescue.’ (2016) 36 *De Rebus* 25.

<sup>121</sup> Ibid at 25.

<sup>122</sup> Section 133(1) of Act 71 of 2008.

<sup>123</sup> *Chetty Nationwide Electrical v Hart NO and another* [2015] JOL 32738 (KZD) at 11

<sup>124</sup> Section 128 (1) of Act 71 of 2008.

<sup>125</sup> Section 145 (1) (a)-(d) of Act 71 of 2008.

creditors because it aims to achieve a result that is more favourable for them than immediate liquidation.

It is frequently the case that creditors will benefit far more from having the debtor back in the market place than from suing the debtor into liquidation.<sup>126</sup> The definition of ‘business rescue’ in the Act recognises both the creditors’ and shareholders’ interest in rescuing a business in such an instance where there is also a reasonable prospect of the company’s recovery.<sup>127</sup> However, owing to this balancing of interests that must necessarily be involved during the implementation of a business rescue, creditors may in some cases see the rescue process as an obstacle standing in the way of a quick collection of debts due and payable.<sup>128</sup> In such instances, it is likely that the certainty of liquidation would be more appealing to creditors.

To prevent potential for abuse of the process, an affected person may apply to court for an order setting aside the resolution, on the grounds that there is no reasonable basis for believing that the company is financially distressed or that there is a reasonable prospect for rescuing the company or that the company has failed to satisfy the procedural requirement.<sup>129</sup> This means that creditors as ‘affected persons’ have the right to apply to court to have the resolution which initiated the business rescue proceedings set aside on the grounds abovementioned and if the creditors manage to persuade the court, then it can make an order placing the company in liquidation.

The Act stipulates that during business rescue proceedings, each creditor is entitled to the following:

- ‘Notice of each court proceeding, decision, meeting or other relevant event concerning the business rescue proceedings;<sup>130</sup>
- Participation in any court proceedings arising during the business rescue proceedings;<sup>131</sup>
- Formal participation in the company’s business rescue proceedings to the extent provided for in the chapter;<sup>132</sup> and

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<sup>126</sup> Bradstreet op cit note 107 at 3756.

<sup>127</sup> Bradstreet op cit note 107 at 376.

<sup>128</sup> Ibid.

<sup>129</sup> Section 130(a) of Act 71 of 2008.

<sup>130</sup> Section 145(1) (a) of Act 71 of 2008.

<sup>131</sup> Section 145(1) (b) of Act 71 of 2008.

<sup>132</sup> Section 145(1) (c) of Act 71 of 2008.

- Informal participation in those proceedings by making proposals for a business rescue plan to the practitioner.<sup>133</sup>

Further to these rights, each creditor has the right to vote to amend, approve or reject a proposed business rescue plan.<sup>134</sup> Should the proposed business rescue plan be rejected, each creditor then has the right to propose the development of an alternative plan<sup>135</sup> or to present an offer to acquire the interests of any or all of the other creditors.<sup>136</sup>

*(a) Creditor's committee*

In terms of the Act<sup>137</sup> creditors of a company are also given the right to form a creditors' committee through which they are entitled to be consulted by the practitioner. Whether or not this committee will be formed is to be determined at the first creditors' meeting which must be convened and presided over by the practitioner within ten business days of their appointment.<sup>138</sup> In addition to discussing the prospect of a creditors' committee, the practitioner must also inform the creditors whether or not they believe that there is a reasonable prospect of rescuing the company.<sup>139</sup>

The practitioner may also receive proof of creditors' claims at this meeting.<sup>140</sup> Notice of the meeting must be sent to every creditor of the company whose name and address is known to, or can reasonably be obtained by the practitioner.<sup>141</sup> In relation to decision-making at these meetings, the Act states that a decision supported by the holders of a simple majority of the independent creditors' voting interests voted on a matter is the decision of the meeting on that matter.<sup>142</sup> This provision does not apply to meetings contemplated in terms of section 151 of the Act.<sup>143</sup>

The creditors committee is not entitled to direct or instruct the practitioner.<sup>144</sup> The committee may receive and consider reports relating to the business rescue proceedings on behalf of the

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<sup>133</sup> Section 145(1) (d) of Act 71 of 2008.

<sup>134</sup> Section 145(2) (a) of Act 71 of 2008.

<sup>135</sup> Section 145(2) (b) (i) of Act 71 of 2008.

<sup>136</sup> Section 145(2) (b) (ii) of Act 71 of 2008.

<sup>137</sup> Section 145(3) of Act 71 of 2008.

<sup>138</sup> Section 147(1) (b) of Act 71 of 2008.

<sup>139</sup> Section 147(1) (a) (i) of Act 71 of 2008.

<sup>140</sup> Section 147 (1) (a) (ii) of Act 71 of 2008.

<sup>141</sup> Section 147(2) of Act 71 of 2008.

<sup>142</sup> Section 147(3) of Act 71 of 2008.

<sup>143</sup> Section 151 of Act 71 of 2008.

<sup>144</sup> Section 149(1) (a) of Act 71 of 2008.

body of creditors.<sup>145</sup> Furthermore, the committee must act independently of the practitioner in order to ensure an unbiased representation of the creditors' interests.<sup>146</sup> In order to be a member of the committee a person must either be an independent creditor, an agent, proxy or attorney of an independent creditor or a person who has been authorised in writing by an independent creditor.<sup>147</sup>

*(b) Protection of property interests*

Another consequence of the business rescue which affect the creditors of the company is that the company is precluded from disposing or agreeing to dispose of any property, unless it is in the ordinary course of business, is a bona fide transaction for fair value at arm's length, approved in advance and in writing by the practitioner or is a transaction contemplated within the business rescue plan.<sup>148</sup> Where the property sought to be disposed of is property over which another person has a security or title interest, the company must obtain the prior consent of that person unless the proceeds of the disposal would be sufficient to fully discharge the indebtedness protected by that person's security or title interest.<sup>149</sup>

The company may then either pay to the person in question the sale proceeds up to the amount of the company's indebtedness to that person,<sup>150</sup> or provide security for the amount of those proceeds to the reasonable satisfaction of the latter.<sup>151</sup> This provision is also protective in nature as the provision of moratorium, but this section specifically provides for the protection of creditors and shareholders by ensuring that the company does not dispose of its assets in the process of business rescue.

*(c) Creditors right in relation to business rescue practitioner*

A business rescue practitioner is an essential ingredient to the successful business rescue proceedings and his conduct directly affects the interests of various stakeholders involved.<sup>152</sup> Given the importance of the practitioner's role during business rescue and therefore the fact that all affected parties will have a real interest in the practitioner who is appointed, it is

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<sup>145</sup> Section 149(1) (b) of Act 71 of 2008.

<sup>146</sup> Section 149(1) (c) of Act 71 of 2008.

<sup>147</sup> Section 149(2) of Act 71 of 2008.

<sup>148</sup> Section 134(1) of Act 71 of 2008.

<sup>149</sup> Section 234(3) of Act 71 of 2008.

<sup>150</sup> Section 134(3) (a) of Act 71 of 2008.

<sup>151</sup> Section 134(3) (b) of Act 71 of 2008.

<sup>152</sup> Bradstreet op cit note 107 at 375.

important to consider what say creditors will have in this regard.<sup>153</sup> When any ‘affected person’ applies to court for an order to commence business rescue proceedings, every other affected person has a right to participate in the hearing of such an application, and to nominate their own practitioner.<sup>154</sup> This provides creditors, as affected persons a good opportunity to protect their interests.<sup>155</sup>

Once in office, a practitioner who proves to be unsuitable may be removed by an affected person through a court application. Such application may be in terms of either s 130(1) or s 139(2).<sup>156</sup> The application in terms of s 130(1)<sup>157</sup> has to be made before the adoption of the rescue plan. It is the application to set aside the entire company resolution that has commenced proceedings, which would have the effect of setting aside the appointment of the practitioner made in terms of the resolution. The provision of s 139(2) also provides for removal of a practitioner from office by the court on any of the following grounds: incompetence or failure to perform duties<sup>158</sup>; failure to exercise the proper degree of care<sup>159</sup>; engaging in illegal conduct<sup>160</sup>; no longer being qualified to serve as practitioner<sup>161</sup>; conflict of interests; lack of independence<sup>162</sup> and that the practitioner is incapacitated and unable to perform the function of that office, and is unlikely to regain that capacity within a reasonable time.<sup>163</sup>

A business rescue practitioner, though, is given effective control of implementing the rescue plan. His wide ranges of powers for overseeing the process may, due to incompetence, partiality or otherwise, serve to undo the measures taken in the Act that aimed at protecting all interested parties.<sup>164</sup> In this sense, the practitioner is the weakest link in the new business rescue procedure. The failure on the part of the business rescue practitioner to perform his duties may harm creditors whose contributions are required for the functioning of a business enterprise and whose reluctance to contribute financially to this would ultimately pose the

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<sup>153</sup> Bradstreet op cit note 107 at 376.

<sup>154</sup> Section 131(5) of Act 71 of 2008.

<sup>155</sup> Bradstreet op cit note 107 at 359.

<sup>156</sup> Section 139(1) of Act 71 of 2008.

<sup>157</sup> Section 130(1) of Act 71 of 2008.

<sup>158</sup> Section 139(2) (a) of Act 71 of 2008.

<sup>159</sup> Section 139(2) (b) of Act 71 of 2008.

<sup>160</sup> Section 139(2) (c) of Act 71 of 2008.

<sup>161</sup> Section 139(2) (d) of Act 71 of 2008.

<sup>162</sup> Section 139(2) (e) of Act 71 of 2008.

<sup>163</sup> Section 139(2) (f) of Act 71 of 2008.

<sup>164</sup> Bradstreet op cit note 107 at 376.

risk of slowing down economic growth in of the country.<sup>165</sup> This is particularly important in the context of the current financial situation, the aim of business rescue being to preserve the integrity of potentially successful business enterprises, assisting them to function as the cogs that drive South Africa's developing economy.

Furthermore, this is broadly relevant in the light of the purposes of the Act, as set out in s 7(b)<sup>166</sup> providing for promotion of the development of the South African economy, and s 7 (g)<sup>167</sup> more specifically for creating optimum conditions for the aggregation of capital for productive purposes.<sup>168</sup> Although protection of a struggling company will serve the interests of investors that hold share capital, creditors ought not to be dealt so unfair a hand that they are discouraged from contributing. In this sense, creditors have an important role to play in sustaining economic growth, and their interests ought therefore to be protected for the good of the broader economy. Their role, however, must not be emphasised to the detriment of the interests of more vulnerable stakeholders and the promotion of socio-economic development in South Africa.<sup>169</sup> This brings in the economy of the South Africa as one of the affected parties in the process of business rescue, though not mentioned as one of the affected person in the Act but it is one of the stakeholders of any company in terms of the Act.

Another issue in relation to the business rescue practitioner which affect the interest of the company's creditors is the issues of remuneration. The practitioner is entitled to charge an amount to the company as remuneration and for incurred expenses in accordance with a prescribed tariff.<sup>170</sup> In addition to this, the practitioner and the company may agree on any further remuneration which is to be calculated on a contingency basis.<sup>171</sup> This remuneration is subject to the approval of the creditors and shareholders of the company.<sup>172</sup> The voting on the remuneration must take place at a meeting which has been called specifically for that reason.<sup>173</sup> Any creditor or shareholder who has voted against this proposed remuneration may approach a court within ten days for an order setting aside the agreement on grounds that it is

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<sup>165</sup> R Bradstreet 'The leak in the Chapter 6 lifeboat: Inadequate regulation of business rescue practitioners may adversely affect lenders' willingness and the growth of the economy' (2010) *SA Merc LJ* 195; 203.

<sup>166</sup> Section 7 (b) of Act 71 of 2008.

<sup>167</sup> Section 7(g) Act 71 of 2008.

<sup>168</sup> R Bradstreet op cit note 165 at 200.

<sup>169</sup> Ibid.

<sup>170</sup> Section 143(1) of Act 71 of 2008.

<sup>171</sup> Section 143(2) of Act 71 of 2008.

<sup>172</sup> Section 143(3) of Act 71 of 2008.

<sup>173</sup> Ibid.

unjust and inequitable or that it is unreasonable considering the company's financial circumstances.<sup>174</sup>

Affording shareholders and creditors such control is sensible if not necessary.<sup>175</sup> It is a significant factor especially if the company is eventually liquidated.<sup>176</sup> This is so because all the expenses and remuneration of the practitioner which have not been paid, rank above the claims of all other secured and unsecured creditors.<sup>177</sup> When one takes into consideration the fact that post-commencement financiers and the employees of the company also enjoy preference then one appreciates that it is of utmost importance to creditors (especially unsecured creditors) that the practitioner is not unreasonably remunerated.

*(d) A better return for creditors*

As it has been stated in previous chapters that section 128 (1) (b)<sup>178</sup> describes business rescue as proceeding to facilitate the rehabilitation of a company that is financially distressed by providing a temporary supervision of the company and its management. To provides a temporary moratorium on claims against the company and the development, approval and implementation of rescue plan to result in either the company's continued existence or, if that is not possible, in a better return for company's creditors or shareholders than would result from the immediate liquidation of the company. The concept of a better return for creditors is an alternative aim of business rescue which is important for the interests of creditors. Business rescue should also generally be attractive to creditors because it aims to achieve a result that is more favourable for them than immediate liquidation.

This alternative objective contained in section 128 (1) (b) (iii) was dealt with by the Supreme Court of Appeal in *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd*.<sup>179</sup> The facts of the case are that Farm Bothasfontein (Kyalami) (Pty) Ltd ('the company') was in default on payments to certain creditors, facing imminent liquidation, the company launched a business rescue application.<sup>180</sup> This application was opposed by Imperial Holdings Ltd and Nedbank Ltd who were also majority shareholders in the company as a result of past

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<sup>174</sup> Section 143(4) of Act 71 of 2008.

<sup>175</sup> M Zwane *Affected Persons in Business Rescue Proceedings: Has a Balance Been Struck?* (Unpublished LLM thesis, University of Cape Town, 2015) 31.

<sup>176</sup> *Ibid.*

<sup>177</sup> *Ibid* at 32.

<sup>178</sup> Section 128(b) of Act 71 of 2008.

<sup>179</sup> *Oakdene Square Properties* supra note 54.

<sup>180</sup> *Oakdene Square Properties* supra note 54 at 8.

financing transactions. Nedbank and Imperial Holdings Limited each held 30 percent of shares of the company and were therefore affected persons by virtue of their shareholdings as well as being creditors of the company. ‘Nedbank and Imperial opposed the business rescue application on the simple basis that any proposal put forward by the practitioner will be rejected as, having 60 percent of the vote, they will vote against it.’<sup>181</sup>

It is common cause between the parties that Kyalami Pty Ltd derived no income from its assets, thus it was apparent from the facts before the court that a successful rescue would not have been possible. It should be noted that the rights of employees as affected persons did not come into consideration in this matter because the company did not have any employees therefore the only competing interests were those of the company and the creditors. The court was thus faced with the question whether to allow access to business rescue proceedings for ensuring a better return for the company’s creditors than might be provided by liquidation proceedings. An application for compulsory business rescue was brought before in terms of section 131 of Act 71 of 2008.<sup>182</sup>

*(e) High court*

In the High Court the issue was whether the best results would be obtained by a liquidator selling the immovable property as the only major asset of the company or whether a business rescue practitioner would be able to do better. The applicant’s case was based on the assumption that business rescue proceedings would be able to realise a higher price, whereas liquidation at a sale in execution would realise a lesser price. The difficulty was that no factual basis had been laid by the applicant’s for justifying such assumptions.<sup>183</sup>

Classen J heard the matter in the high court and declined to grant the order placing the company under supervision, the Judge laid down distinct reasons for concluding that an order for business rescue was inappropriate in this case however these do not need to be replicated here.<sup>184</sup> It sufficient to say that the main amongst those reasons was the expressed intention of the creditors and majority shareholders to vote against any proposed business plan as well as the court’s view that a liquidator would be best equipped to deal with the litany of issues and complexity of this case, further the court could see no reason why a liquidator would be less

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<sup>181</sup> *Oakdene Square Properties* supra note 54 at 11.

<sup>182</sup> *Oakdene Square Properties* supra note 54.

<sup>183</sup> *Oakdene Square Properties* supra note 54 at 48.

<sup>184</sup> *Oakdene Square Properties* supra note 54 at 49.

successful in realizing a proper market value for the relevant property.<sup>185</sup> Another important factor was what the courts call the balancing exercise, here the court decided that the interests of creditors ought to carry more weight when weighed against those of the company.<sup>186</sup>

*(f) The Supreme Court of Appeal*

In the (Supreme Court of Appeal<sup>187</sup> there were a few issues to be considered, these issues were: The nature of the court's discretion under s 131(4) of the Act; the meaning of 'reasonable prospect' in s 131(4) (a) (iii); and the meaning of 'rescuing the company'. The nature of the court's discretion does not fall within the scope of discussion for this dissertation and the meaning of reasonable prospect has already been discussed by the previous chapter. The only issue that will be considered in this chapter is the meaning of rescuing the company.

The debate surrounding the meaning of rescuing the company arises out of the definition provided for in terms of the Act under s 128 (1) (h), read with s 128 (1) (b) (iii). According to s 128 (1) (h)<sup>188</sup>, 'rescuing the company' means 'achieving the goals set out in the definition of 'business rescue' in paragraph (b)'. In this light, the debate arose whether the satisfaction of the said alternative object of business rescue was sufficient to constitute a successful rescue where the proposed rescue plan provides for the secondary goal only.

The court in its interpretation of s128 (1) (b) stated that 'business rescue' means to facilitate 'rehabilitation', which in turn meant the achievement of one of two goals: (a) to return the company to solvency, or (b) to provide a better deal for creditors and shareholders than what they would receive through liquidation. Further the court stated that this construction coincides with the reference in s 128 (1) (h) to the achievement of the goals set out in s128 (1) (b). The judge placed emphasis on the term 'goals' being a plural term, to drive his point home.<sup>189</sup>

Accordingly, the court accepted that the achievement of any one of the two goals referred to in s 128 (1) (b) would qualify as 'business rescue' in terms of s131 (4) of the Act.<sup>190</sup> After settling the above issue, the question quickly turned on whether there was a 'reasonable

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<sup>185</sup> *Oakdene Square Properties* supra note 54 at 49.

<sup>186</sup> *Oakdene Square Properties* supra note 54 at 49.

<sup>187</sup> *Oakdene Square Properties* supra note 54.

<sup>188</sup> Section 128 (h) of Act 71 of 2008.

<sup>189</sup> *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* (609/2012) [2013] ZASCA 68 (27 May 2013) 26.

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

prospect' present. The court after considering the facts and circumstances of the matter was not convinced that there was a reasonable prospect present. The court explained the difficulty which was also faced by the court a quo in that it could see no reason why a business practitioner would be able to obtain a better price for the property than a liquidator. The court stated that the contention appeared to rest on nothing more than speculation.<sup>191</sup>

The court seemed to condone some of the reasons laid down by the high court in its dismissal of the application and added some of its own reasons for dismissing the appellant's arguments. The court in conclusion was of the view that there was a real possibility that liquidation would in fact be more advantageous to creditors and shareholder.<sup>192</sup>

The court further stated that if facts were present that showed that there can be a reasonable possibility of rescuing the company, the court might use its discretion and grant the application.<sup>193</sup> In light of the circumstances of the case, particularly that there was no reasonable prospect of rescue, no facts were placed before the court by the applicant in support of its argument in this case. It accordingly failed to show that business rescue would yield a better return for the company's creditors. The court thus dismissed the application for business rescue.<sup>194</sup>

*(g) Analysis of the Oakdene Square Properties case*

This case is important because it gives understanding of the new position of creditors in the paradigm shift towards a business rescue model based on 'debtor-friendliness'. It seems clear that 'debtor-friendliness' in this context does not amount to 'creditor-unfriendliness', and that the right of creditors to liquidation is not in any way undermined by the new business rescue procedure.<sup>195</sup> 'Rescuing' the company does not mean salvaging the wreck at all costs, but rather making an appropriate use of the business rescue procedure to facilitate an outcome that is in the interests of all stakeholders.<sup>196</sup>

A very interesting question regarding the alternative objective of the business rescue is whether the new procedure can legitimately be used as a means of extracting value from an ailing

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<sup>191</sup> *Oakdene Square Properties* supra note 157 at 34.

<sup>192</sup> *Oakdene Square Properties* supra note 157 at 34.

<sup>193</sup> *Oakdene Square Properties* supra note 157 at 34

<sup>194</sup> *Oakdene Square Properties* supra note 157 at 40

<sup>195</sup> R Bradstreet, 'Business rescue proves to be creditor-friendly: C J Claassen J's analysis of the new business rescue procedure in *Oakdene Square Properties*' 2013 *SALJ* 50.

<sup>196</sup> *Ibid.*

company which is going towards liquidation.<sup>197</sup> Since there is no requirement that a successful rescue be ‘reasonably likely’ in the case of an application brought by an affected person, it seems as though the procedure must have been intended for purposes other than actually ‘rescuing’ the business, particularly where complete ‘recovery’ is impossible.<sup>198</sup> The judgment of Claassen J in *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* is a good illustration of the potential value in taking a pragmatic approach to insolvency proceedings, and if business rescue is able to achieve a broader purpose than that which is determined by a literal meaning of the term, courts ought to allow that purpose in so far as it aligns with the purposes of the Act and equitably balances the interests of the relevant stakeholders.<sup>199</sup> Section 7(d) of the Act also recognises a wider purpose of the legislation being ‘to reaffirm the concept of the company as a means of achieving economic and social benefits’. There is clearly an economic benefit in using Chapter 6 as a means to extract value from a financially distressed company, and in cases where extended employment is possible, a social benefit also results.

#### IV. CONCLUSION

Creditors’ rights during the business rescue proceedings are limited by the application of moratorium but the Act contains several provisions and right to make sure that their interests are still protected. Their interests are protected by the secondary object of business rescue as discussed in the previous paragraphs and this seem to be placing creditors and a company on equal footing while this does not defeat the primary object of the rescue procedure. This is evidenced by a number of rights given to creditors for example the appointment and removal of the business rescue practitioner from the office. The fact that the primary emphasis of a reorganisation or rescue was placed on the interests of creditors has been identified as a cause of the failure of judicial management, and the new business rescue has addressed this problem without unduly prejudicing creditors, as it is stated that shifting towards debtor-friendliness does not amount to creditor- unfriendliness.

Procedural benefits in the rescue mechanism are placed primarily in the company, but creditors follow in priority. Where creditors are unhappy during the rescue procedure, they will be afforded sufficient protection. When business rescue is successful, creditors are able to benefit

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<sup>197</sup>Ibid 52.

<sup>198</sup>Ibid.

<sup>199</sup>R Bradstreet op cit note 195 at 52.

by having the debtor back in the marketplace. As much as creditor's right and interests are affected by the implementation of the business rescue proceeding, business rescue should generally be attractive to creditors because it aims to achieve a result that is more favourable for them than immediate liquidation.

## CHAPTER FOUR

### EFFECTS OF BUSINESS RESCUE ON SHAREHOLDERS

#### I. INTRODUCTION

The shareholders of the company are also one of the affected persons mentioned in the Act, but they are afforded narrower rights than those given to creditors as affected persons. Shareholders are one of the stakeholders who are affected by business rescue and because of this reason they must be involved in the process of business rescue due to their financial interest in the company. A successful business rescue will impact positively on their share prices and consequently their dividends, in a sense that shares will gain at least their previous value.<sup>200</sup> On the other hand, the consequence of failure of the company's rescue procedure will be a loss on their part as the share value will drop. Thus, it is important for any shareholder to understand his rights in the business rescue process to make informed decisions.

This chapter will discuss the rights afforded to shareholders in the business rescue process, participation and the possible influence they have in the outcome of the procedure. It will examine to what extent the new corporate rescue allows for their participation and involvement, and whether the business rescue procedure will meaningfully improve shareholders position in the corporate rescue regime. Shareholders have been given limited voting rights where the proposed business rescue does not affect their shares despite the fact that their financial interest in the company still remains. This chapter will discuss the implication of such limitation.

#### II. GENERAL PARTICIPATION RIGHT

According to the Act<sup>201</sup> during a company's business rescue proceedings, each holder of any issued security of the company has the following rights:

- a) 'to receive notice of each court proceeding, decision, meeting or other relevant event concerning the business rescue proceedings<sup>202</sup>;
- b) participates in any court proceedings arising during the business rescue proceedings<sup>203</sup>;

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<sup>200</sup> A Loubser 'The role of shareholders during corporate rescue proceedings: Always on the outside looking in?' (2008) 20 *SA Merc LJ* 37.

<sup>201</sup> Act 71 of 2008.

<sup>202</sup> Section 146 (a) of Act 71 of 2008.

<sup>203</sup> Section 146 (b) of Act 71 of 2008.

c) formally participates in a company's business rescue proceedings to the extent provided for in this Chapter<sup>204</sup>;

d) vote to approve or reject a proposed business rescue plan in the manner contemplated in this section<sup>205</sup>, if the plan would alter the rights associated with the class of securities held by that person and

e) if the business rescue plan is rejected, to:

(i) Propose the development of an alternative plan, in the manner contemplated in section 153; or

(ii) Present an offer to acquire the interests of any or all the creditors or other holders of the company's securities in the manner contemplated in section 153.<sup>206</sup>

On the face of it shareholders are afforded the same rights as the other affected persons, more especially creditors of the company. This is evident by the referring to the definition of business rescue, which is a better return for the company's creditors and shareholders, thus implying that the interests of shareholders are equal to those of creditors.<sup>207</sup> However, there is an argument that although shareholders of the company are given formal recognition as affected persons in the business rescue procedure, and have the right to be notified of important events, and to participate in court procedures, their position has not improved very much in real terms.<sup>208</sup>

This is so because shareholders are entitled to vote as creditors in instances where they have made loans to the company, however, they will not be construed as independent creditors. It follows therefore that where the rescue plan has no effect on shareholders' rights they would be precluded from voting. This seems quite an acute limitation on the rights of shareholders considering their financial interest. Another effect that is presented by business rescue on the company's shareholders is the exclusion of shareholders from the right to form a committee specifically for them as afforded to creditors and employees of the same company. Furthermore, the Act prescribes that the practitioner must hold meetings with each of the

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<sup>204</sup> Section 146 (c) of Act 71 of 2008.

<sup>205</sup> Section 146 (d) of Act 71 of 2008.

<sup>206</sup> Section 146 (e) (i) (ii) of Act 71 of 2008.

<sup>207</sup> Section 128 (1) (b) (iii) of Act 71 of 2008.

<sup>208</sup> Loubser op cit note 200 at 372.

stakeholders to inform them about the state of the company and to determine whether said committees ought to be formed. Shareholders, on the contrary, are not so empowered.

As an affected person, a single shareholder is authorised to bring an application to begin business rescue proceedings as per the provision of section 131(1)<sup>209</sup> of the Act discussed in previous chapters, however it is doubtful whether a shareholder will find it possible to prove any of the requirements as discussed in chapter two, without the co-operation of the directors, as proving such requires information not immediately at the disposal of a shareholder even if he suspects that the company is in trouble.

Considering the existing case law on the just and equitable requirement for judicial management, it seems unlikely that any court will find it just and equitable to commence rescue proceedings on the application of a shareholder, particularly if opposed by a creditor.<sup>210</sup> For an example in the case of *Francis Edward Gormely*<sup>211</sup> discussed in chapter two, Gormley, a major shareholder of the company, applied for the company's business rescue. The court indicated that not a single fact was put forward to prove that there was a reasonable prospect that the company will be able to carry on business on a solvent basis or that the business rescue plan will yield a better result for creditors and shareholders than liquidation, only generalisations were put forward.<sup>212</sup>

The approach taken by the courts in business rescue applications thus far confirms this argument because the only affected persons that have been successful in bringing such applications so far have been the creditors and employees or trade unions respectively. By all these above-mentioned instances, it is submitted that the shareholders of the company during business rescue proceedings have been unduly prejudiced by the Act.

### III. RIGHTS OF SHAREHOLDERS IN RELATION TO THE BUSINESS RESCUE PLAN

The Act prohibits an alteration in the classification or status of any issued securities of a company during business rescue proceedings, other than by way of a transfer of securities in the ordinary course of business unless the court directs otherwise or it is contemplated in an

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<sup>209</sup> Act 71 of 2008.

<sup>210</sup> Loubser op cit note 200 at 372.

<sup>211</sup> *Francis Edward Gormely v West City Precinct Properties (Pty) Ltd* 19076/11 (WCC) 18 April 2012.

<sup>212</sup> *Ibid* at 11.

approved business rescue plan.<sup>213</sup> If the business rescue plan purports to have such an effect, shareholders must approve the plan before it is adopted. In preparing the plan, the practitioner is compelled to consult with all affected persons.<sup>214</sup>

Shareholders do not have the right to form a shareholder's meeting, whereas creditors and employees do. Some have argued that there is no need for such a committee as shareholders partake in general meetings of the company; however, a committee meeting during business rescue is very much different to the company's usual meetings. What is important about the committee meetings is that stakeholders get the opportunity to discuss and voice their opinions to the practitioner about concerns they may have about the business rescue plan and the procedure. Most importantly, stakeholders are present to ensure that their interests are protected. Without the opportunity to consult with the business rescue practitioner the general body of shareholders will mostly be left in the dark.

#### IV. ADOPTION OF A BUSINESS RESCUE PLAN

In terms of the Act shareholders will only be able to vote on a plan if it purports to alter the rights of the holders of any class of the company's securities.<sup>215</sup> In the event that a proposed business rescue plan purports to alter any class of holders of the company's securities then the practitioner must immediately hold a meeting of holders of the class, or classes of securities whose rights would be altered by the plan, and call for a vote by them to approve the adoption of the proposed business rescue plan.<sup>216</sup> If, in a vote contemplated, a majority of the voting rights that were exercised support adoption of the plan, it will be finally adopted, subject only to satisfaction of any conditions on which it is contingent;<sup>217</sup> but if the adoption of the plan is opposed, the plan is rejected, and may be considered further only in terms of section 153.<sup>218</sup>

A business rescue plan that has been adopted is binding on the company, and on each of the creditors of the company and every holder of the company's securities, whether or not such a person was present at the meeting or voted in favour of adoption of the plan.<sup>219</sup> If the business rescue plan was approved by the shareholders of the company the practitioner may amend the company's Memorandum of Incorporation to authorise, and determine the preferences, rights,

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<sup>213</sup> Section 137(1) of Act 71 of 2008.

<sup>214</sup> Section 150(1) of Act 71 of 2008.

<sup>215</sup> Section 152(3) (c) of Act 71 of 2008.

<sup>216</sup> Section 152(3) (c) (i) of Act 71 of 2008.

<sup>217</sup> Section 152(3) (c) (ii) (aa) of Act 71 of 2008.

<sup>218</sup> Section 152(3) (c) (ii) (bb) of Act 71 of 2008.

<sup>219</sup> Section 152(4) of Act 71 of 2008.

limitations and other terms of, any securities that are not otherwise authorised, but are contemplated to be issued in terms of the business rescue plan.<sup>220</sup> A pre-emptive right of any shareholder of the company will not apply with respect to an issue of shares by the company in terms of the business rescue plan unless an approved business rescue plan provides otherwise.<sup>221</sup>

Looking at both the primary and secondary objects of business rescue, the Act states that it is the task of the business rescue practitioner to analyse the rescue plan before him and decide whether either of the two objects will be accomplished. With this being said it is imperative that shareholders are given a seat at the table, to consider and vote on the adoption of the business rescue plan regardless of whether or not the proposed plan purports to alter their class of shares because eventually they will be affected by whatever result the business rescue proceeding brings at the end of the day.

## V. CONCLUSION

What is certain from the reference in the definition of ‘business rescue’ is that the main goal of the proceedings is for the company to survive. Therefore, there can be no doubt that shareholders have a very real and continued interest that deserves protection during the process.<sup>222</sup>

Shareholders are entitled to notices and to participate in court proceedings regarding business rescue to the extent provided, they are entitled to vote on a business rescue plan only if the proposed plan purports to alter the rights associated with the class of securities held by that person. Shareholders are also entitled to bring an application to commence business rescue proceedings in terms of section 131 of the Act. These rights ensure participation in the business rescue process but some of these provisions of the Act are not implemented and others unfairly prejudice shareholders.

Unlike creditors and employees, shareholders are not empowered to form a shareholder’s committee; this is a factor which is unfairly prejudicial to shareholders. No explanation or substantial reason has been put forward by the legislators of the Act for this blatant exclusion

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<sup>220</sup> Section 152(6) (b) of Act 71 of 2008.

<sup>221</sup> Section 152(7) of Act 71 of 2008.

<sup>222</sup> Loubser op cit note 165 at 372.

of shareholders. The fact that shareholders are entitled to vote on a business rescue plan only if the proposed plan purports to alter the rights associated with the class of securities held by that shareholder, make the shareholders not to be fully involved in the important decisions that will affect their shares.

All the above highlighted sections of the Act and the arguments presented thereafter that flow from those discussed sections, have been intended to provide critical analysis for the purposes of legislative development in the area of business rescue. While the progress thus far is greatly applauded, there still remains room for improvement regarding the participation rights of interested and affected parties, more particularly, those referring to shareholders.

## CHAPTER FIVE: EFFECT OF BUSINESS RESCUE ON EMPLOYEES AND EMPLOYMENT CONTRACTS

### I. INTRODUCTION

In terms of the Act,<sup>223</sup> ‘affected person’ means ‘any registered trade union representing employees of the company;<sup>224</sup> and if any of the employees of the company are not represented by a registered trade union, each of those employees or their representatives’.<sup>225</sup> Employee’s rights in the Act are so extensive that in some instances they impact on the operation of a successful business. According to Cassim, employees have been ‘given a vital role in the business rescue proceedings’ in a process that is ‘consultative and inclusive’ in nature and have thereby become influential participants of business rescue through rights and privileges afforded to them in the Act.<sup>226</sup> However, the merits of employee participation in business rescue proceedings is a controversial subject in general but even more so in the context of the South African industrial relations environment.

It is important therefore to review the potential effect of employee participation in business rescue in the South Africa’s new Companies Act.<sup>227</sup> The effect of the business rescue process on the employees and employment contracts does not only impact on the employees but also on the economy of the country and the community as the secondary stakeholders of the company, and thus the provisions found in the employment law and the Act<sup>228</sup> have to be interpreted in such a manner that they bring about positive impact of saving the jobs, since unemployment is one of the current national issues plaguing South Africa, and in turn causing poor economic growth.

### II. THE EFFECT OF THE BUSINESS RESCUE ON THE EMPLOYEES AND CONTRACTS

The supreme rule of law when it comes to employment law in South Africa is section 23 of the Constitution of the Republic of South Africa,<sup>229</sup> which provides for the employee’s right to fair labour practice.<sup>230</sup> The legislature then enacted the Labour Relations Act<sup>231</sup> (LRA) and the

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<sup>223</sup> Act 71 of 2008.

<sup>224</sup> Section 128(1) (ii) of Act 71 of 2008.

<sup>225</sup> Section 128(1) (iii) of Act 71 of 2008.

<sup>226</sup> Cassim op cit note 6 at 861.

<sup>227</sup> Companies Act of Act 71 of 2008.

<sup>228</sup> Ibid

<sup>229</sup> Constitution of the Republic of South Africa, 1996.

<sup>230</sup> Section 23 (1) - (5) of the Constitution.

<sup>231</sup> Labour Relations Act 66 of 1995.

Basic Conditions of Employment Act (BCEA)<sup>232</sup> which give effect to this constitutional right to fair labour practices. One of the purposes that are clearly stated in the Act<sup>233</sup> is to ensure compliance with the Bill of Rights in the constitution and this also gives effect to the right to fair labour practices.<sup>234</sup> The employee's rights found in the Act stem from three sections of the Act,<sup>235</sup> the first one is the inclusion of employees in the definition of 'affected persons' who enjoy a wide range of powers and rights.<sup>236</sup> The second one is the recognition of employees as creditors, in cases where the company owes them any remuneration that was due before commencement of business rescue.<sup>237</sup> Then the last one is simply based on the fact that they are employees of the company.<sup>238</sup>

The rights of employees have received limited protection in the past, whereas in the liquidation proceedings employees are immediately put off work after a company is ordered by the court to be liquidated. The new Companies Act offers a solution to end the unfairness and prejudice previously suffered by employees in the insolvency regime. The provisions of the Act are made to prevent immediate loss of employment.<sup>239</sup>

Section 131 of the Act allows employees, through their classification as 'affected persons, to make an application to place a company under supervision. The court was approached with such an application in the matter between *Employees of Solar Spectrum Trading 83 (Pty) Ltd v AFGRI Operations Limited and Solar Spectrum Trading 83 (Pty) Ltd*,<sup>240</sup> where the employees of a company in distress which was in the process of being liquidated, successfully applied for the company to be placed under supervision. The application had the effect of suspending the liquidation proceedings.

The court weighed up the interests of the secured creditor in reducing its risk of further depletion of the company assets through immediate liquidation with the interests of the

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<sup>232</sup> Basic Conditions of Employment Act 75 of 1997.

<sup>233</sup> Act 71 of 2008.

<sup>234</sup> Section 7 (a) of Act 71 of 2008.

<sup>235</sup> Act 71 of 2008.

<sup>236</sup> Section 128(1) (a) of Act 71 of 2008.

<sup>237</sup> Section 144(2) of Act 71 of 2008.

<sup>238</sup> Act 71 of 2008.

<sup>239</sup> A Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (unpublished LLD dissertation, UNISA, 2010) 53.

<sup>240</sup> *Solar Spectrum Trading* supra note 71.

employees whose livelihoods depended on the preservation of the business and ruled for the employees on evidence presented that the business was in the process of recovering.<sup>241</sup>

While this was a legitimate and productive exercise of the employee's right to suspend liquidation proceedings if commenced, in terms of section 131 (6) of the Act, there is real potential that this right could be abused due to the fact that employees obtain considerably better rights under business rescue which are later transferred to insolvency proceedings if the rescue attempt fails. There is also an assertion that the fact that an individual employee may also make an application to court to commence business rescue proceedings is of great concern.<sup>242</sup> An example of such abuse of the proceedings would be where an aggrieved employee may abuse their right to force a company into accepting their demands in a situation where the company may have a good reason for a dismissal of the employee in accordance with the relevant legislation.

This right may be abused for employee's advantage in negotiations, where an unsatisfactory wage settlement based on affordability, could be used as a ground for instituting rescue proceedings as stated in previous chapters.<sup>243</sup> Whilst the likelihood of such an application succeeding is slim where a company is in good health, an action such as this is not without serious consequences.<sup>244</sup>

The impact of such an application by the employee creditors of the company can severely undermine the reputation and creditworthiness of the company.<sup>245</sup> In addition there is a very real risk that actual damage can arise because the application for rescue in isolation does not invoke the moratorium as contemplated in section 133 of the Act. This only comes into effect when an order for rescue proceedings has been granted by the court. In the case of malicious abuse of section 131 of the Act by an aggrieved employee, a moratorium will never come into effect because the order will not be granted. This could therefore expose a healthy company to a potentially devastating 'run on its assets'.<sup>246</sup>

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<sup>241</sup> *Solar Spectrum Trading* supra note 71 at 359.

<sup>242</sup> HC Schoeman, 'The rights granted to Trade Unions under the Companies Act 71 of 2008' (2013) *PER/PELJ* 237.

<sup>243</sup> Loubser op cit note 239 at 53.

<sup>244</sup> *Ibid.*

<sup>245</sup> *Ibid* at 54.

<sup>246</sup> Loubser op cit note 239 at 85.

The application for business rescue by affected persons should therefore not be taken lightly, and the grounds required for making an application in terms of the Act should be substantial. It is for this reason that the bar is set high in section 131 read with section 128 (f) of the Act which provides that an order shall not be granted in an application to place a business into rescue unless the court is satisfied that a business is in distress. This requires that a company is either found to be unable to pay its debts or that it will become insolvent within the ensuing six months as it has been discussed in chapter two above.<sup>247</sup> However, the provisions of section 131 (3) (a) (ii)<sup>248</sup> of the Act bring back the impact that an otherwise healthy company, not financially distressed which has failed to make a single payment to a single employee could be put at risk through the misguided exercise of this provision.

It is for this reason that Schoeman<sup>249</sup> suggests that legislature needs to revisit the provisions of chapter 6 and recommends that only majority registered trade unions or, at least, sufficiently represented trade unions in the workplace be given the right to apply to court. Further that the rights afforded to trade unions are afforded only to trade unions that are a creditor of the company.

The specific provision of the Act dealing with the effect of business rescue on employees and employment contracts is section 136.<sup>250</sup> It states that during business rescue, the employees of the company continue to be employed on the same terms and conditions.<sup>251</sup> This is not absolute however as the Act makes provision for changes which occur in the ordinary course of attrition,<sup>252</sup> and where the company and the employees agree on different terms.<sup>253</sup> Where any retrenchment of employees is contemplated within the business rescue plan, the Act stipulates that this must be done in accordance with sections 189 and 189A of the LRA as well as any other applicable employment related legislation.<sup>254</sup> Employment contracts are further protected by being excluded from the scope of the practitioner's powers to suspend contracts that the company may be party to.<sup>255</sup>

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<sup>247</sup> Sections 131 and 128 of Act 71 of 2008.

<sup>248</sup> Section 131(3) (a) (ii) of Act 71 of 2008.

<sup>249</sup> Schoeman op cit note 242 at 237.

<sup>250</sup> Section 136 of Act 71 of 2008.

<sup>251</sup> Section 136(1) (a) of Act 71 of 2008.

<sup>252</sup> Section 136(1) (a) (i) of Act 71 of 2008.

<sup>253</sup> Section 136(1) (a) (ii) of Act 71 of 2008.

<sup>254</sup> Section 136(1) (b) of Act 71 of 2008.

<sup>255</sup> Section 136(2) of Act 71 of 2008.

The relevant case dealing with the provisions of section 136 is the case of *Solidarity Obo BD Fourie & others v Vanchem Products (Pty) Ltd & others (Vanchem)*<sup>256</sup> which is the first known reported decision on retrenchment of employees by a business rescue practitioner. Here the trade union challenged the lawfulness of the retrenchment of employees by the practitioner.

The National Union of Metalworkers (NUMSA) argued that unless the retrenchment of any employees employed at the time business rescue proceedings commence occurs in terms of an approved business rescue plan, then the termination of their services is unlawful because it is in breach of section 136 (1) (a).<sup>257</sup> The question that the court had to answer was whether ‘the wording of section 136(1) of the Act meant that where an employer is in business rescue, employees cannot be retrenched except as provided for in the business rescue plan, which must first be approved by creditors? In other words, can the employer (or the business rescue practitioner) embark on a section 189 process based on the employer’s immediate (and often pressing) operational needs before the business rescue plan has been approved?’<sup>258</sup>

The court stated that section 136(1) of the Companies Act consists of two distinct parts:

- (a) it affirms the continuity of existing terms and conditions of employment; and
- (b) it imposes an obligation on the business rescue practitioner to affect any retrenchments in compliance with the LRA.<sup>259</sup>

The court noted that the construction of section 136(1) (a) (i) of the Companies Act, particularly the reference to the words ‘the ordinary course of attrition’, could arguably be interpreted as providing a guarantee of employment, as opposed to merely preserving conditions of employment. However, the court was of the view that to interpret the words ‘ordinary course of attrition’ as providing a guarantee of employment would, in essence, mean that a company in business rescue would not be able to terminate the employment of any of its employees with

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<sup>256</sup> *Solidarity Obo BD Fourie & others v Vanchem Products (Pty) Ltd & others; In re: National Union of Metalworkers (NUMSA) Obo Members v Vanchem Vanadium Products (Pty) Ltd & another* (J385/16 & J393/16 [2016] ZALCJHB 106, 22 March 2016).

<sup>257</sup> *Ibid* at 34.

<sup>258</sup> A Johnson & M Bux ‘Can a retrenchment process start before a business rescue plan has been approved?’ available on <https://www.ensafrika.com/news/can-a-retrenchment-process-start-before-a-business-rescue-plan-has-beenapproved?Id=2181&STitle=employment%20ENSight>, accessed on 29 September 2018

<sup>259</sup> *Solidarity Obo BD Fourie* supra note 217 at 35.

the company for whatsoever reason, whether or not such termination was fair in terms of the LRA.<sup>260</sup>

This would be inconsistent with the remaining provisions of section 136(1). Therefore, the court found that the phrase ‘ordinary course of attrition’ must be read to include all forms of lawful termination, including retrenchments.<sup>261</sup> With respect to section 136(2) of the Companies Act, the court concluded that:

‘Section 136(2) permits a business rescue practitioner to suspend obligations owed by the company at that time business rescue proceedings commenced. Section 136(2A) exempts employment contracts from this power of suspension. Once again, the provisions deal with the suspension of obligations, but are silent on the question of the lawful termination of obligations. Considering the section, it seems the primary object of the section was to prevent the unilateral variation of company obligations by a business rescue practitioner, but to permit the business rescue practitioner to suspend the performance of certain contractual obligations except those relating to employees. It does not seem to be directed at preventing the lawful termination of obligations including employment contracts. Consequently, I am not persuaded that the provisions of section 136 effectively outlaw any retrenchments taking place except in terms of an approved business plan.’<sup>262</sup>

As per this judgment of Vanchem it seems that the business rescue practitioner is entitled to retrench employees of a company, provided there is compliance with section 189 of the LRA, the business rescue practitioner would have to show that the proposed retrenchments are based on the employer’s proper and justifiable operational needs and requirements as was the case in this matter.

### III. THE GENERAL PARTICIPATION RIGHTS OF EMPLOYEES

The rights of employees are similar in most respects to those of creditors discussed above, and they are provided for in section 144 of the Act.<sup>263</sup> The Act states that during a company’s business rescue proceedings any employees of the company who are represented by a registered trade union may exercise any rights set out in the chapter 6 of the Act.<sup>264</sup> They may exercise such rights collectively through their trade unions and in accordance with applicable labour

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<sup>260</sup> Ibid.

<sup>261</sup> Ibid.

<sup>262</sup> *Solidarity Obo BD Fourie* op cit note 217 para 36.

<sup>263</sup> Section 144 of Act 71 of 2008.

<sup>264</sup> Section 144(1) (a) of Act 71 of 2008.

law.<sup>265</sup> The employees that are not represented by registered trade unions may elect to exercise any rights set out in this chapter either directly, or by proxy through an employee organisation or representative.<sup>266</sup>

The employees or trade union representing the employees are entitled to a notice given in a prescribed manner and form, of each court proceeding, decision, meeting or other relevant event concerning the business rescue proceedings.<sup>267</sup> They have the rights to form a committee of employees' representatives,<sup>268</sup> to be consulted by the practitioner during the development of the business rescue plan and to be afforded sufficient opportunity to review any such plan.<sup>269</sup> They have the right to vote with creditors on a motion to approve a proposed business plan, to the extent that the employee is a creditor.<sup>270</sup> These provisions make it clear that employees of the company are extensively involved and may actively participate and interact with the business rescue practitioner to make sure their interests are protected during the proceedings.

*(a) Remuneration*

The Act provides that employees will rank as preferred concurrent creditors for any employment-related remuneration or expenses incurred which becomes due and payable before the commencement of business rescue and remains unpaid at the commencement thereof.<sup>271</sup> In relation to remuneration or reimbursement for employment-related expenses which became due and payable during the business rescue, the Act stipulates that these are to be regarded as post-commencement finance.<sup>272</sup>

A medical scheme or a pension scheme (including a provident scheme) for the benefit of past or present employees is an unsecured creditor of the company<sup>273</sup> However, this is only to the extent that any amount was due and payable by the company to the trustees of the scheme before commencement of business rescue and remained so unpaid.<sup>274</sup> In the case of a defined benefit pension scheme, the limitation is the present value of any unfunded liability under the

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<sup>265</sup> Section 144(1) (a) (i)-(ii) of Act 71 of 2008.

<sup>266</sup> Section 144(1) (b) of Act 71 of 2008.

<sup>267</sup> Section 144(3) (a) of Act 71 of 2008.

<sup>268</sup> Section 144(3) (c) of Act 71 of 2008.

<sup>269</sup> Section 144(3) (d) of Act 71 of 2008.

<sup>270</sup> Section 144(3) (f) of Act 71 of 2008.

<sup>271</sup> Section 144(2) of Act 71 of 2008.

<sup>272</sup> Section 135(1) (a) of Act 71 of 2008.

<sup>273</sup> Section 144(4) of Act 71 of 2008.

<sup>274</sup> Section 144(4) (a) of Act 71 of 2008.

scheme at the commencement of business rescue.<sup>275</sup> The Act goes further and stipulates that the rights mentioned herein (as well those to be discussed immediately hereafter) are in addition to any other rights accruing in terms of any law, contract, collective agreement, shareholding, security or court order.<sup>276</sup>

#### IV. CONCLUSION

It is apparent from the above discussion of the provisions of the Act that the employees of the company are given a vital role in the business rescue proceedings. Previously employees have been the most disadvantaged group in the industrial relations in South Africa and some argue that this is one of the reasons the concept of business rescue came into place in South African law. However, this privilege and protection provided to employees in the new South African rescue procedure has undermined many of the key elements that are necessary for successful business rescue. There is no discernible rationale for enabling a single employee to initiate business rescue proceedings on account of a single payment being skipped by the company. There are other provisions that need to be reconsidered by the legislature when it comes to the rights of employees of the company under business rescue in order to avoid the corporate rescue failure experienced under judicial management.

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<sup>275</sup> Section 144(4) (b) of Act 71 of 2008.

<sup>276</sup> Section 144(5) of Act 71 of 2008.

## CHAPTER SIX

### COMPARATIVE ANALYSIS BETWEEN THE EFFECTS OF BUSINESS RESCUE AND THE EFFECTS OF JUDICIAL MANAGEMENT ON STAKEHOLDERS OF THE COMPANY

#### I. INTRODUCTION

As it has been pointed out in previous chapters, business rescue was introduced as a means of rectifying the failure that has been experienced under judicial management. The impact of the judicial management mechanism on companies' stakeholders has contributed to its failure as a corporate rescue method with its emphasis on the interests of creditors and thus undermining the interests of other stakeholders. Until this point there has not been any comparison between the two corporate rescue mechanisms that have been introduced in South Africa, as most academics have compared South African judicial management with other countries, and business rescue proceedings of South Africa with those of other jurisdictions as well.

This chapter will briefly compare judicial management and business rescue as a previous and a current corporate rescue mechanism of South African corporate law. Although judicial management has been replaced with business rescue, it is still important to compare its effects against those of the new business rescue so that the eyes of the legislatures and executors will be opened to avoid the same causes of failure and rectify any indicators as early as possible.

#### II. JUDICIAL MANAGEMENT VERSUS BUSINESS RESCUE

As it has been stated above judicial management was first introduced in South African company law by the Companies Act 46 of 1926<sup>277</sup> at a time when the concept of business rescue was still virtually unknown in any other comparable legal system.<sup>278</sup> Judicial management was subsequently re-enacted in the Companies Act 61 of 1973,<sup>279</sup> and this was despite the representation made proposing that it should be abolished on the grounds that it had a low success rate and was being abused.<sup>280</sup> The provision of the old Act states that a judicial manager may be provisionally appointed when a company is unable to pay its debts or would probably be unable to pay its debts and there is a reasonable probability that it will be enabled to pay its

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<sup>277</sup> Companies Act 46 of 1926.

<sup>278</sup> A Loubser 'Judicial management as a business rescue procedure in South African corporate law' (2004) 16 *SA Merc LJ* 139.

<sup>279</sup> Companies Act 61 of 1973.

<sup>280</sup> Loubser op cit note 278 at 139.

debts or to meet its obligations and become a successful concern if it is placed under judicial management.<sup>281</sup>

Normally such an order will be accompanied by a moratorium on enforcement proceedings by creditors.<sup>282</sup> Thus, the requirements for judicial management as contained in section 427(1) of the old Act are different from those of business rescue found in the Act as discussed in chapter two above. The old Act provides that a company may be placed under judicial management if by reason of mismanagement or for any other course:

- (i) 'the company is unable to pay its debts or probably unable to meet its obligations;
- (ii) the company has not become or is prevented from becoming a successful concern;
- (iii) there is a reasonable probability that if the company is placed under judicial management it will be enabled to pay its debts and meets its obligation and become a successful concern;
- and
- (iv) it appears just and equitable to the court'.<sup>283</sup>

The first specific requirement set by section 427(i) is that the company must be unable to pay its debts or probably unable to meet its obligations.<sup>284</sup> The term obligation has a wider meaning than the mere payment of debts and includes obligations which the company foresees that it will probably be unable to meet. However, as the requirement is stated in the present tense, it is submitted that this would have to be in the immediate or foreseeable future.<sup>285</sup> With regards to the new business rescue the requirement is the failure to pay any amount as discussed in chapter two above, which means that an applicant may apply for business rescue orders relying on non-payment of amounts due in respect of contractual or statutory obligations relating to employment matters.<sup>286</sup>

This requirement is designed to protect employee creditors specifically in that proving a mere breach of an employment contract would be sufficient grounds to obtain a business rescue order when there is also a reasonable prospect of success. Thus, employees and trade unions are afforded equal rights as creditors to commence business rescue in the Act<sup>287</sup> unlike in judicial management where only creditors were protected and able to apply for an order, as the old Act

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<sup>281</sup> Section 427(1) of Act 61 of 1973.

<sup>282</sup> Section 428 (2) of Act 61 of 1973.

<sup>283</sup> Section 427(1) of Act 61 of 1973.

<sup>284</sup> Section 427(1) (a) of Act 61 of 1973.

<sup>285</sup> Loubser op cit note 278 at 147.

<sup>286</sup> Section 131(4) (a) (ii) of Act 71 of 2008.

<sup>287</sup> Bradstreet op cit note 43 at 41.

stipulated that only those persons that are entitled to apply for winding up of a company can apply for judicial management.<sup>288</sup> This means the application may only be made by the company itself, by one or more of its creditors or prospective creditors, by one or more of its members or jointly by any of them.<sup>289</sup> The second requirement is that the company has not become or is prevented from becoming a successful concern was replaced by the requirement to prove that a company is financially distressed. The requirement that it must be just and equitable in the eyes of the court to make such an order is maintained in the new business rescue provision.

Another requirement which contributed more in the judicial management failure is the third requirement listed above. It places a very heavy burden of proof on the applicant who has to prove a reasonable probability and not merely a possibility, that the company will be enabled to pay its debts and meets its obligation and become a successful concern if it is placed under judicial management. In *Porterstraat 69 Eiendomme (Pty) Ltd v PA Venter Worceser (Pty) Ltd (Porterstraat)* the court stated the requirement once more in very clear terms when it said that the respondent must show that if an order of judicial management is granted the company can be restored to total solvency.<sup>290</sup> The Act<sup>291</sup> uses the term reasonable prospect as a burden of proof instead of reasonable probability as indicated in the discussion of the requirement for business rescue in chapter two of this paper. Section 129 requires the applicant to prove that there appears to be a reasonable prospect of rescuing the company.<sup>292</sup>

When the provisional judicial management order is granted, the provisional judicial manager takes over management of the business of the company from the incumbent management, investigates the situation of the company and reports to meetings of creditors and members convened by the Master.<sup>293</sup> The meetings of creditors and members consider the desirability of placing the company under final judicial management.<sup>294</sup> After this, the provisional judicial manager reports to the court on the prospect of the company being able to become a successful concern or to pay its debts within a reasonable time.<sup>295</sup> Once the provisional judicial manager has reported to the court and the court decides to make a final order, the judicial manager

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<sup>288</sup> Section 427(2) of Act 61 of 1973.

<sup>289</sup> Section 346(2) of Act 61 of 1973.

<sup>290</sup> *Porterstraat 69 Eiendomme (Pty) Ltd v PA Venter Worceser (Pty) Ltd* 2000(4) SA 568 (C) at 616.

<sup>291</sup> Act 71 of 2008.

<sup>292</sup> Section 129 of Act 71 of 2008.

<sup>293</sup> Section 430 of Act 61 of 1973.

<sup>294</sup> Section 431(2) of Act 61 of 1973.

<sup>295</sup> Section 432(2) of Act 61 of 1973.

continues to run the business to the exclusion of the former management and under the supervision of the Master.<sup>296</sup> The aim is to restore the company to be a successful concern.<sup>297</sup>

Judicial management was regarded as an infringement on the rights of creditors because it prevented them from exercising their right to liquidate a company to obtain payment of their claims, and therefore judicial management could be ordered only under special circumstances. Thus, the courts felt compelled to guard against this infringement of creditors' rights by interpreting the already extremely onerous requirements for judicial management in such a way that it became virtually impossible to place a company under judicial management.<sup>298</sup> One of the best examples of this approach is found in *Silverman v Doornhoek Mines Ltd (Silverman)*<sup>299</sup> to which the courts frequently referred when deciding whether to grant an application for judicial management.

In this case, the court stated that the procedure of judicial management is a special and extraordinary procedure and a special privilege given in favour of a company and is to be authorised only in very special circumstances. This attitude by South African courts is a factor that restricts the use of judicial management as a measure to rescue companies. It is submitted that there is no compelling reason why the courts should view judicial management as an extraordinary measure. There is certainly nothing in the legislation that merits its treatment as such.<sup>300</sup>

Another failure for judicial management is its present emphasis on the protection of the interests of creditors rather than the rescuing of the company or its business. This approach ignores the facts that the rescue of a company would have benefits reaching much further than the company's immediate creditors.<sup>301</sup> The provisions of the Companies Act 2008, in stark contrast with the 'creditor-friendly' focus of the preceding legislation, aim more specifically at the rescue of a business, and therefore, at least on the face of it, appear more debtor- friendly. This is evident by the provision of s 7(k) as stated in previous chapters, that one of the purposes of the Act itself is to effect successful rescues in a manner that balances the rights and interests

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<sup>296</sup> Section 433 of Act 61 of 1973.

<sup>297</sup> Section 427(1) of Act 61 of 1973.

<sup>298</sup> A Loubser 'Tilting at windmills? The quest for an effective corporate rescue procedure in South African law' (2013) 25 *Merc LJ* 454.

<sup>299</sup> *Silverman v Doornhoek Mines Ltd* 1935 TPD at 349.

<sup>300</sup> P Kloppers 'Judicial management- a corporate rescue mechanism in need of reform' (1999) 3 *Stell LR* 426.

<sup>301</sup> A Loubser op cit note 298 at 139.

of all relevant stakeholders.<sup>302</sup> It identifies a number of different stakeholders and empowers them as ‘affected persons’ to participate throughout the process.

### III. OVERALL CONCLUSION

Business rescue is a new corporate rescue structure in South Africa that was introduced in the Companies Act 71 of 2008.<sup>303</sup> The Act was drafted with certain expressed objectives to ensure an efficient business rescue process that would facilitate the rescue and rehabilitation of business entities in financial difficulty in a way that would secure and balance the opposing interest of directors, shareholders and employees. This is one of the greatest achievements in the South African corporate law as it has far more reaching advantages for a company compared to liquidation. Besides the objective of securing and balancing the opposing interests of the stakeholders, it is submitted that there is also an economic advantage to saving a corporate entity because of tax implications.

A company going into liquidation signifies the loss of taxpayers’ jobs and subsequently a reduction in the tax base. Employees would be out of work and entities would be closed and they would cease to contribute to the country’s tax system.<sup>304</sup> In the case of *Gormley v West City Precinct Properties (Pty) Ltd & another* the court held that the intention of the legislature by enacting chapter 6 is to prevent the negative impact on economic and social affairs by rescuing companies rather than liquidating them.<sup>305</sup>

The new corporate rescue system, unlike the liquidation process and the previous system of judicial management, which has disproportionately protected creditors more than other stakeholders, shifts its primary focus from the interests of the creditors to a broader range of interests. It has addressed this issue without unduly prejudicing creditors as the shift from debtor-friendliness does not amount to creditor- unfriendliness.

Business rescue has significantly improved the position of shareholders of the company by first specifically mentioning them as affected persons in section 128 of the Act<sup>306</sup> and giving them the rights to participate in the business rescue proceedings,<sup>307</sup> which was not the case with

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<sup>302</sup> Section 7(k) of Act 71 of 2008.

<sup>303</sup> Joubert op cit note 17 at 563.

<sup>304</sup> Bradstreet op cit note 43 at 52.

<sup>305</sup> *Gormley v West City Precinct Properties (Pty) Ltd & another; Anglo Irish Corporation v West City Precinct Properties (Pty) Ltd & another* [19075/11, 15584/11] [2012] ZAWCHC 33 (18 April 2012) at 43.

<sup>306</sup> Section 128(1) (a) (i) of Act 71 of 2008.

<sup>307</sup> Section 131(3) of Act 71 of 2008.

judicial management. However, these rights of shareholders are limited in the sense that shareholders are entitled to notices and to participate in court proceedings regarding business rescue and to the extent provided, they are entitled to vote on a business rescue plan only if the proposed plan purports to alter the rights associated with the class of securities held by that person.<sup>308</sup> This makes shareholders not to be fully involved in the important decisions that will affect their shares. Unlike creditors and employees, shareholders are not empowered to form a shareholder's committee; this is a factor which is unfairly prejudicial to shareholders. There has been no explanation or substantial reason put forward by the legislators of the Act for this blatant exclusion of shareholders.<sup>309</sup>

Employees' of the company again have been positively affected by the transition from judicial management to business rescue. As indicated in the chapter dealing with employees that previously, employees have been the most disadvantaged group in the industrial relations in South Africa and some argue that this is one of the reasons the concept of business rescue came into place in South African law.

Although the new business rescue is a remarkable improvement from the old judicial management system as indicated in the discussion above, there is still room for improvement. This paper makes submission that legislature needs to revisit the provisions contained in chapter 6 in this early stage, because the provisions of the Act still have some degree of uncertainty and gaps which might bring back the same failure that the rescue system encountered under judicial management. Perhaps one might assume that legislature has provided loose wordings to some of the provisions in order to allow a wider variety of interpretations to the provisions, as the business rescue process is a fairly new field of corporate law, and therefore, broader as opposed to narrower interpretations are welcomed by the legislature/ courts at this point. However, in pursuance of those broad interpretations, caution must be taken in order to avoid a mis-contextualisation by the enforcers and interpreters of such legislation, and that the language used therein must retain its intended meaning.

It is submit that the empowerment of shareholders in the process will go a long way, provision must be made for a shareholder's committee that will represent the general shareholders of the company; this will ensure that the interests of shareholders are protected and provided for

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<sup>308</sup> Section 146 (*d*) of Act 71 of 2008.

<sup>309</sup> Kloppers op cit note 300 at 425.

extensively, it will give shareholders the chance to consult with the business rescue practitioners about the plans and future of the distressed company. Shareholders should also have the right to vote to reject or approve the business rescue plan regardless of whether the proposed plan purports to alter the rights of the holders of any class of the company's securities, because the adopted business rescue plan will apply to all stakeholders even though they did not vote or had voted against the plan. Voting for the adoption of a business rescue plan is a very important step because it could mean the beginning or the end of the business rescue process.

The privilege and protection provided to employees of the company in the new South African rescue procedure has undermined many of the key elements that are necessary for successful business rescue. There is no discernible rationale for enabling a single employee to initiate business rescue proceedings on account of a single payment being skipped by the company. Thus, there has to be a limitation of these rights to avoid the negative implications of such over protection. It is suggested above that only majority registered trade unions or, at the least, sufficiently represented trade unions in the workplace be given the right to apply to court and the rights afforded to trade unions be allowed only to trade unions that are a creditor of the company.<sup>310</sup> For example, an individual employee or the registered trade union should be allowed to apply to court for a company to be placed under supervision only in the event were employees have not been paid salaries for two to three months owing to the company's financial difficulty.

As previously iterated above, all the above highlighted sections of the Act and arguments presented are not presented to criticise the provisions and process of business rescue but they mean to suggest some of the important aspects that the legislature should reconsider in the new provision of business rescue provided for in the Act.<sup>311</sup>

Business rescue has been successful in some cases and it has the added advantage that its weaknesses have been clearly identified and should therefore be easy to eliminate in this early stage with all the solutions suggested. Furthermore, it seems unlikely that the ideal solution would be found in replacing business rescue unless we decide to go back and implement the already existing procedure of winding up companies without giving them another chance of

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<sup>310</sup>H C Schoeman op cit note 242 at 237.

<sup>311</sup> Act 71 of 2008.

coming back to life.<sup>312</sup> A developing economy like South Africa cannot lightly permit companies which help to comprise its industries and commercial enterprises to be dissipated by winding-up and dissolution due to some temporary setback in cases where there is a reasonable prospect that they would, if they are placed under business rescue and granted a moratorium, be able to overcome their difficulties, discharge their debts and become successful concerns.<sup>313</sup>

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<sup>312</sup>A Loubser op cit note 298 at 162.

<sup>313</sup>J Henning 'Judicial management and corporate rescue in South Africa' (1992) 17 *Tydiskrif Vir Regswetenskap* 91.

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