A critical discussion of the requirements of business rescue in terms of the Companies Act 71 of 2008

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This mini-dissertation is submitted in partial fulfilment of the requirements for the degree of Master of Laws in Business Law.

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2020

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M. ISMAIL

15 November 2020

ACKNOWLEDGMENTS

To my parents, thank you for all your support over the years.

Thank you, Dr Subramanien, for your guidance and patience in the writing of this dissertation.

Thank you to the postgraduate administrator, Ms Robynne Louw, for her assistance during my postgraduate studies.

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LIST OF ABBREVIATIONS

1973 Act	Companies Act 61 of 1973
2008 Act	Companies Act 71 of 2008
ANC	African National Congress
BR plan	Business rescue plan
BRP	Business rescue practitioner
CC	Close corporations
CEO	Chief executive officer
CFO	Chief financial officer
CIPC	Companies and Intellectual Property Commission
Covid–19	Coronavirus disease
DPE	Department of Public Enterprises
DTI	Department of Trade and Industry
ESKOM	Electricity Supply Commission
LRA	Labour Relations Act 66 of 1995
MoI	Memorandum of Incorporation
MTBPS	Medium–Term Budget Policy Statement 2020
NRF	National Revenue Fund
OA	Opportunity analysis
PCF	Post–commencement Finance
PFMA	Public Finance Management Act 1 of 1999
PwC	Price Waterhouse Coopers
SAA	South African Airways
SAAT	SAA Technical
SABC	South African Broadcasting Corporation
SATC	South African Travel Centre
SCA	Supreme Court of Appeal
SMMEs	Small, medium and micro–enterprises
SOE	State–owned enterprise
UA	Union Airways
UIF	Unemployment Insurance Fund
US	United States

ABSTRACT

Despite business rescue being approximately ten–years–old with several court judgments available in South Africa, certain legal terminology in the Companies Act 71 of 2008 ('the 2008 Act') are still ambiguous. This study includes an overview of the old administration to emphasise that the issue could have been resolved in the 2008 Act.

Under the novel regime, it is the task of the business rescue practitioner to temporarily administer the assets and dealings of the business by restructuring the business, property, debt, other liabilities, and equity (section 128(1)(b)). The objective would be to either emerge from the process solvent or a better return for creditors (or immediate liquidation as a final route). However, the two built-in requirements, namely, the company must be 'in financial distress', and there must be a 'reasonable prospect' of success, is unclear as the 2008 Act does not provide what standard of proof is required in these instances.

Accordingly, this study analyses the two gateways into business rescue and the abovementioned requirements to begin the process. It is suggested that the general moratorium and post-commencement finance and the implications in practically executing the statutory obligations be considered concurrently.

Thereafter, this study includes a discussion on South African Airways, the first state-owned entity to be placed under voluntary business rescue on 5 December 2019.

The study concludes by recommending methods that the court and a business rescue practitioner could utilise in interpreting the requirements for the process to be more effective. For example, the courts and a business rescue practitioner may use a pre-assessment for determining 'financial distress' together with financial and cash-flow ratios. For 'reasonable prospect', a pre-assessment is recommended, as well as an opportunity analysis (OA) and a 'do we have a business?' test (DWaB test).

CHAPTER 1

I BACKGROUND

(a) Introduction

Historically, South African companies had only three options for saving businesses experiencing gradual deterioration. First, s 427 of the Companies Act 61 of 1973 ('1973 Act') governed the procedure for judicial management.[1] Secondly, s 311 of the 1973 Act made provision for an offer of compromise or a scheme of arrangement. Lastly, a non–statutory, informal disposition without court intervention.[2]

Since 1926, a formal corporate rescue procedure was initiated in South Africa under the Companies Act 46 of 1926 and judicial management was subsequently adapted in the 1973 Act with little amendments.[3] The latter was further developed in the Companies Act 71 of 2008 ('2008 Act') and referred to as business rescue, which is the refreshing option that replaced judicial management.[4]

The new statutory regime can be found under Chapter 6 'Business rescue and compromises with creditors' within the 2008 Act.[5] A new legislative provision to replace judicial management with a dispensation aligning South African company law in line with international economic principles of corporate rescue was needed.[6] Due to the 1973 Act not making enough provision for companies in financial distress, the only alternative available to these companies was liquidation, which resulted in their management looking internationally at options to restructure their affairs.[7]

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1 D Gewer 'Legal aspects of turnarounds' in N Harvey *Turnaround management & Corporate Renewal – A South African Perspective* (2011) 560; P T J Bezuidenhout *A review of business rescue in South Africa since implementation of the Companies Act (71/2008)* (unpublished MBA thesis, North–West University, 2012) 8.

2 Ibid.

3 A Loubser 'Business Rescue in South Africa: A Procedure in Search of a Home?' (2007) 40(1) *CILSA* 153.

4 Ibid.

5 O Mokoena 'The Philosophy of Business Rescue Law' (2019) 5(1) *Journal of Corporate and Commercial Law & Practice* 3.

6 P Kloppers 'Judicial Management – A corporate rescue mechanism in need of reform?' (1999) 10 *Stell LR* 434.

7 E Levenstein *An Appraisal of the New South African Business Rescue Procedure* (published LLD thesis, University of Pretoria, 2015) 52.

According to legal scholars in the corporate insolvency space, financial distress is commonly viewed as an 'exogenous development'.[8] They believe the situation is as a result of outside factors that hold a company back from discharging its quick assets to satisfy their obligations.[9] For this reason, the United States ('US') Congress adopted the Bankruptcy Reform Act of 1978, which influenced the 2008 Act by stressing restructuring as opposed to liquidation.[10] They highlighted the concern of preserving employment, assets, and the law, by allowing companies trouble–free protection under Chapter 11.[11]

Essentially, Chapter 11 of the US Bankruptcy Code favours a more 'debtor–friendly approach', and which by the same token, the 2008 Act tried to accomplish. In 2004, the 'South African Company Law for the 21st Century: Guidelines for Corporate Law Reform' is a policy paper published by the Department of Trade and Industry ('DTI'). The DTI expressed their efforts to align South Africa with other contemporary corporate–rescue regimes.[12] It recognises the relationship between a debtor and creditor which, under this plan, could encompass a decrease in the debtor's financial obligations.[13]

In essence, the judicial management provisions only made a moratorium available where a 'reasonable probability' was established, and this basically overlooked the global reality that creditors may rather accept a reduced payment of debt than none at all.[14] It is of more value to the creditor to have the debtor in operation, rather than placing them into liquidation, which results in the discontinuation of that company.[15] Hence, there was a need for a business rescue, which called for an agreement with the majority of creditors assenting to place the ailing company under the plan, allowing for business dealings to resume as normal. [16]

The purpose of business rescue is to aid and effectively rescue financially distressed companies, together with balancing the rights and interests of all stakeholders involved, which was not effective in the old regime.[17] The process is intended to provide a reasonable balance between the interests of the debtor company and the creditors themselves. The former

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8 M Bradley & M Rosenzweig 'The Untenable Case for Chapter 11' (1992) 101 *Yale Law Journal* 1043–1044.

9 Ibid.

10 Ibid. Chapter 11 of the U S Bankruptcy Code refers to the Bankruptcy Reform Act of 1978 as amended.

11 Ibid.

12 H Rajak & J Henning 'Business Rescue for South Africa' (1999) 116 *SALJ* 286.

13 GN 1183 *GG* 26493 of 23 June 2004 at 45.

14 Rajak & Henning op cit note 12 at 286.

15 Ibid.

16 Ibid.

17 Section 7(k) of Companies Act 71 of 2008 ('2008 Act').

is given the opportunity to prepare a rescue plan with some protection from action by creditors and the latter have a right to vote on the plan.[18]

There are two gateways to bringing an application, namely, the board of directors ('BOD') of the company may pass a resolution to place the company under business rescue;[19] or an affected party may apply to court.[20] The application by the board is a simple procedure entailing notification to the concerned parties and the Companies and Intellectual Property Commission of South Africa ('CIPC').[21] In the event of a company looking to abuse the process, by using the moratorium to avoid creditors' claims, an affected party can respond by making an application to set aside such claims.[22]

For a court to grant an application for business rescue, specific requirements need to be satisfied. For voluntary business rescue, the board of the company must satisfy the court that it is in financial distress, and a reasonable prospect of rescuing the company exists.[23] An affected party would have to make an order to court, with the satisfaction of the above pre–conditions or alternative requirements, including: the company's inability to pay an amount for public regulation; contractual obligation; or where it is just and equitable for financial reasons.[24]

(b) Rationale

This study aims to explore, *inter alia*, the requirements to commence business rescue in terms of Chapter 6, and to emphasise those areas that have proven to be problematic considering previous outcomes. One of these requirements is the concept of 'reasonable prospect', which is a key provision for determining whether business rescue may be viable.

The study of business rescue is a novel and topical concept in South Africa as it is a mechanism that aims to solve economic predicaments, achieve commercial pursuits, and rejuvenate financially distressed companies.

Additionally, after analysing the requirements to commence business rescue, this study investigates how they apply to state–owned enterprises ('SOEs'). The role and functions of SOEs are regulated in the new Companies Act and the Public Finance

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18 J Rushworth 'A critical analysis of the business rescue regime in the Companies Act 71 of 2008' (2010) *Acta Juridica* 275.

19 Section 129(1) of the 2008 Act.

20 Section 131(4) of the 2008 Act.

21 See *http://www.cipc.co.za/index.php/publications/business-rescue/*, accessed on 12 July 2020.

22 Section 130(1)(*a*)(i–iii) of the 2008 Act.

23 Section 129(1)(*a–b*) of the 2008 Act.

24 Section 131(4)(*a*)(i–iii) of the 2008 Act.

Management Act.[25] South African Airways ('SAA') was 'financially distressed' in both instances of this definition at the time the business rescue process was invoked, as discussed in Chapter 3.

Likewise, for a SOE to succeed in an application for business rescue, the requirement of financial distress would need to be satisfied. Conventionally, the boards of SOEs have relied on state–guaranteed funding (from the National Treasury) and have the option of guarantees to reduce the risk of being financially distressed in terms of s 128(1) of the 2008 Act.[26] Cassim raises the question of whether 'business rescue is available to companies that are already insolvent?'[27] This was after SAA entered into business rescue but was factually insolvent, with its liabilities exceeding its assets by almost R 13 billion.[28]

Moreover, the contention that SOEs who continue to rely on government guarantees may still be regarded as being in a state of financial distress would depend on 'whether or not state guarantees can ensure that all the debts due by the company can be repaid, or whether certain creditors will remain unpaid.'[29]

Historically, we have not witnessed any SOE that has experienced the business rescue process until SAA was placed under voluntary business rescue during early December of 2019.[30] Hence, there is uncertainty surrounding the prospects for SOEs under this procedure.

Many trade unions are in support of the restructuring to preserve jobs and avoid privatisation of the SOE with the ruling political party, the African National Congress (ANC) reinforcing this. However, economists Roodt and Abedian believe that SAA cannot be saved, and placing them into business rescue would have the effect of more guarantees and more taxes.[31] Abedian adds that incrementally, fuel levy, sin taxes, and the income tax will also rise.[32] Levenstein believes that the process would be beneficial for distressed SOEs as it allows them to come out as solvent at the end of the process, protects employment, and that

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25 1 of 1999 ('PFM Act').

26 E Levenstein 'South Africa's state–owned enterprises: prime candidates for business rescue?' (2018) *Without Prejudice* available at *https://www.withoutprejudice.co.za/publication/2018/October/articles*, accessed on 15 July 2020.

27 M F Cassim 'South African Airways makes an emergency landing into business rescue: Some burning issues' (2020) 137(2) *SALJ* 201.

28 'South African Airways lost over $700 mln in past 2 years' available at *https://www.dailymaverick .co.za/article/2019-12-02-south-african-airways-lost-over-700-mln-in-past-2-yearsdocuments/*, accessed on 18 July 2020.

29 Levenstein op cit note 26.

30 Ibid.

31 S Mkhwanazi 'Economists slam ANC inaction on SOEs' *IOL News* 27 January 2020 available at *https://www.iol.co.za/news/politics/economists-slam-anc-inaction-on-soes41414943-*, accessed on 10 July 2020.

32 Ibid.

SOEs are 'prime candidates' for this process.[33] Furthermore, this make–or–break moment could serve as a lesson and option for other SOEs (such as SABC and ESKOM) in financial distress.

(c) Research questions

This study outlines the development of the new Companies Act as a corporate rescue procedure against the requirements under s 427(1) of the 1973 Act, and some of the shortcomings experienced with the new regime are analysed.

The study mainly focuses on the requirements for a board resolution to commence business rescue proceedings in terms of s 129(1) of the 2008 Act and a compulsory application in terms of s 131(4) of the 2008 Act. The main requirements are then evaluated against the background of the shortcomings experienced with judicial management. In conjunction with the purpose of this study, the following questions are examined:

(1) Whether the requirements for business rescue have resulted in the successful implementation of business rescue?
(2) How can the problematic requirements be neutralised?
(3) How are the requirements applied in light of SOEs?

(d) Research methodology

A desk–based research methodology is adopted for the purposes of this study and several resources are consulted. The dissertation reviews previous research findings in order to gain a broad understanding of the field. The research comprises of both primary and secondary sources in print and electronic format.

(e) Anticipated limitations

This study focuses on the main legislative requirements to commence business rescue in terms of ss 129(1)(*a*–*b*) and ss 131(4)(*a*)(i–iii) of the 2008 Act. This study also mentions s 133 (the general moratorium) and s 135 (post–commencement finance) of the 2008 Act, as they relate to the aforementioned requirements.

[33] Levenstein op cit note 26.

(f) Overview of chapters

This dissertation is structured into four chapters, in order to enable a critical discussion on whether there have been significant developments in terms of business rescue in South Africa. Chapter 1 is an introduction that provides a brief overview of the development of business rescue in South Africa. It includes the research questions, objectives, significance of the study, its limitations, research methodology, and the chapter outline.

Chapter 2 follows an analysis of the requirements of the 2008 Act against the backdrop of the 1973 Act. More specifically, reference is made to the inadequacy experienced with judicial management. The aim is to discuss the requirements in terms of ss 129(1)(*a*–*b*) and ss 131(4)(*a*)(i–iii) of the 2008 Act. Regardless of the path taken, the challenges relating to 'financial distress', 'reasonable prospect', and the possible solutions submitted would apply in both instances.

Chapter 3 provides a discussion of the current and first SOE under the process, SAA, and subsequently the extent to which the requirements were satisfied, together with the implications of a general moratorium and post–commencement finance.

Chapter 4 provides an overview on the shortcomings of business rescue with recommendations that can be implemented in order to improve the business process.

CHAPTER 2

I JUDICIAL MANAGEMENT IN TERMS OF THE COMPANIES ACT 61 OF 1973

(a) Introduction

In retrospect, the Companies Act 46 of 1926 introduced judicial management and this marked South Africa as being one of the earliest countries to initiate a corporate rescue system.[1] There were various commissions of enquiry that resulted in little revision of the Act. Some amendments occurred in 1932,[2] and the Lansdown Commission introduced some changes, followed by reports of the Millin Commission in 1952.[3] During 1972, the masters of the supreme court wanted judicial management to be abolished because of the minor degrees of success. However, the Van Wyk de Vries Commission reflected on establishing the Companies Act which was later retained under the 1973 Act. Consequently, Olver, Rajak and Henning[4] highlight that, at the time, under twenty per cent of the applications were successful and suggested that in order to avoid the abuse of the process it should be ultimately removed.[5]

The 1973 Act requirements stated when and how a distressed company might initiate the process to commence the proceedings: there must be mismanagement; or the inability to pay debts; or meets obligations.[6] Subsequently, the company must be failing to become a successful concern. If placed under the process, there is a reasonable probability that it can discharge its debts and obligations, hence, become a successful concern. Furthermore, the court may grant an order if it finds it just and equitable to do so.[7]

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1 H Rajak & J Henning 'Business Rescue for South Africa' (1999) 116 *SALJ* 265.

2 Ibid. The fundamental changes were a section for a moratorium on claims by creditors and the principles of impeachable transactions to apply also to judicial management.

3 D A Burdette 'Some initial thoughts on the development of a modern and effective business rescue model for South Africa (part 1)' (2004) 16 *SA Merc* 246.

4 A H Olver Judicial management in South Africa (unpublished PhD thesis, University of Cape Town, 1980). See also Rajak & Henning op cit note 1 at 266.

5 Ibid.

6 Section 427(1)(*a*) of the Companies Act 61 of 1973 ('1973 Act').

7 Section 427(1)(*b*) of the 1973 Act.

(b) Limitations of the 1973 Act

To provide some context as to why reform was needed, the main limitations of the 1973 Act need to be addressed. First, judicial management was time–consuming as opposed to liquidation and was regarded as an 'extraordinary' process.[8] Accordingly, the requirements of proving a 'reasonable probability' was more difficult for the company, and improbable, considering the short timelines and the pressure of creditors.[9]

Burdette[10] submits that 'reasonable probability' should have instead been phrased as 'reasonable prospect' or 'reasonable possibility'.[11] The other requirement that needed to be satisfied was that the company must have already been insolvent.[12] Kloppers[13] argues the contrary by submitting that a company would be better positioned to restructure and avoid liquidation if it takes early steps to prevent the entrapment of insolvency.[14] If the latter requirement was satisfied, the provision of 'just and equitable' would have still needed to be established. Despite the phrase (just and equitable) not being defined, the courts consider the rights and interest of all parties in order to determine this prerequisite.[15]

Secondly, aside from the flawed requirements to commence judicial management, the cost to initiate it only added to the expenses of the distressed company.[16] This financial barrier was even more exclusionary for small–medium businesses.[17] Thirdly, the 1973 Act does not apply to partnerships, business trusts, or close corporations ('CCs').[18] In *Tobacco Auctions Ltd v AW Hamilton (Pvt) (Ltd),*[19] the court stated that apart from the size of a company one must assess the business performance, asset holdings, the complexity of the issue experienced, and its liabilities.[20] Kloppers[21] submits that, this assessment could have been a reference to determining the requirement of 'just and equitable'.[22]

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8 Burdette op cit note 3 at 247.
9 C Stein & G Everingham *The new Companies Act unlocked* (2011) 409.
10 D A Burdette 'Unified Insolvency Legislation in South Africa: Obstacles in the Path of the Unification Process' (1999) 32 *De Jure* 44 at 58.
11 Ibid.
12 Burdette op cit note 3 at 250.
13 P Kloppers 'Judicial management reform: Steps to initiate a business rescue' (2001) 13 *SA Merc* 359
14 Ibid.
15 P M Meskin et al *Henochsberg on the Companies Act 61 of 1973* 5ed (Service issue 33) (2011) 923.
16 Kloppers op cit note 13 at 371.
17 Rajak & Henning op cit note 1 at 268.
18 Burdette op cit note 3 at 250.
19 1966 (2) SA 451 (R) at 453 ('*Tobacco Auctions*').
20 Ibid.
21 Kloppers op cit note 13 at 371.
22 Ibid.

Fourthly, the main reasons why restructuring was unsuccessful was that the process included courts, which translated to the legal procedures being time–consuming and costly, and this was more burdening to companies in financial distress. Fifthly, Gewer[23] states that, the judicial managers who replaced the directors of a company did not have the necessary skills to save the distressed companies.[24] Finally, according to Roodt,[25] judicial management was impractical and had a negative effect on the goodwill of the company, he described the outcome of the procedure as the 'kiss of death'.[26]

(c) Business rescue in terms of the Companies Act 71 of 2008

The outbreak of the Covid–19 pandemic has led many countries, including South Africa, into a national lockdown, which has increased the loss of jobs and decreased the levels of economic production.[27] This international pandemic could mean the end of many companies as they are unable to meet their financial obligations and are left with the only one option, liquidation.[28]

Considering that this route is final, it may not be the best option for some companies experiencing temporary financial difficulty. Alternatively, Chapter 6 of the 2008 Act is the next option for companies in financial distress.[29] In some instances, failing companies should naturally be liquidated in competing markets when dominated by tough rivals, and this, in turn, prevents the business rescue process from potential abuse and presents the consumer with the best goods and services.[30]

Business rescue intends on reviving the company by staying creditors' claims, and liquidation applications after business rescue has commenced via the creation of a moratorium.[31] A registered and qualified business rescue practitioner ('BRP') is appointed to

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23 D Gewer 'Legal aspects of turnarounds' in N Harvey *Turnaround management & Corporate Renewal – A South African Perspective* (2011).

24 Ibid.

25 J Roodt 'Business rescue under the new Companies Act is an improvement over judicial management: The strengths and weaknesses of business rescue under the new Companies Act' available at *http://www.roodtinc.com/archive/newsletter78.asp*, accessed on 20 August 2020.

26 Ibid.

27 K Timoney & P J Veldhuizen 'Insolvency and restructuring in the post–pandemic world: The role of liquidation and business rescue' (2020) 10(1) *CR* 25.

28 Ibid at 28.

29 Ibid.

30 D Davies (ed), W Geach (ed) & T Mongalo et al *Companies and other Business Structures in South Africa* 3ed (2013) 235.

31 Section 133(1) of the 2008 Act.

temporarily administer the assets and dealings of the business. The ultimatum would be the development and implementation of the business rescue plan ('BR plan'), when approved, to:

> 'Restructure its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.'[32]

The purpose of business rescue is to aid and effectively rescue financially distressed companies, together with balancing the rights and interests of all stakeholders involved, which was not effective in the old regime.[33] According to Rushworth,[34] the process is intended to provide a reasonable balance between the interests of the debtor–company and the creditors themselves. The former is allowed to prepare a BR plan with some protection from action by creditors, and the latter have a right to vote on the BR plan.[35]

There are two gateways to bringing an application: the BOD of the company may pass a resolution (known as 'board resolution' or 'voluntary commencement') to place the company under business rescue;[36] or an affected party may apply to the court (known as a 'court application' or 'compulsory application').[37]

For a voluntary business rescue to commence, the board of the company must satisfy the court that it is in financial distress, and that a 'reasonable prospect' of rescuing the company exists.[38] An affected party would have to make an order to court, with the satisfaction of the above pre–conditions, or alternative requirements, including the company's inability to pay an amount for public regulation, contractual obligation, or where it is just and equitable for financial reasons.[39]

Despite business rescue being approximately ten–years–old with several court judgments available in South Africa, there is still uncertainty around legal terminology being defined in the Companies Act of 2008. The two built–in requirements are mainly discussed as they apply for both commencement by a board resolution and court application.

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32 Section 128(1)(*b*)(iii) of the 2008 Act.
33 Section 7(k) of the 2008 Act.
34 J Rushworth 'A critical analysis of the business rescue regime in the Companies Act 71 of 2008' (2010) *Acta Juridica* 275.
35 Ibid.
36 Section 129(1) of the 2008 Act.
37 Section 131(4) of the 2008 Act.
38 Section 129(1)(*a*–*b*) of the 2008 Act.
39 Section 131(4)(*a*)(i–iii) of the 2008 Act.

(i) The company must be in financial distress

In assessing whether a company is financially distressed, a company must either be 'commercially insolvent' whereby the company is unable to pay its debts as they fall due, or is presumably 'factually insolvent' in that the company's liabilities exceed its assets at any time. Factual and commercial insolvency has been recognised as the two forms of insolvency for decades in our law.[40] In both instances, the time frame is within the next six months.[41] It excludes insolvent companies to rationalise that imminent insolvency must be 'diagnosed and treated at an early stage before the condition becomes incurable.'[42] In *Gormley v West City Precinct Properties (Pty) Ltd*,[43] Traverso DJP highlighted that

> 'the Act envisages a short–term approach to the financial position of the company. This is so for self–evident reasons. There must be a measure of certainty in the commercial world. Creditors cannot be left in a state of flux for an indefinite period. The provisions of the Act make it clear that the concept of business rescue only applies to companies which are financially distressed as defined in the Act.'[44]

The 2008 Act does not define what is meant by either terms 'solvent–' or 'insolvent company'. However, in *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd*[45] the supreme court of appeal ('SCA') has indicated that, business rescue may commence if one of the two forms of insolvency occur. In *Murray v African Global Holdings (Pty) Ltd*,[46] Wallis JA states that, in determining commercial insolvency, the current and imminent financial standing of the company must be considered in examining its ability to pay its debts and remain trading within those periods.[47] The court assumed that the vague concepts could be in relation to the judicial interpretations of solvency and insolvency being effective and ensuring that 'sensible and business–like' outcomes persist in determining their meanings.[48]

There are two tests in determining financial distress. According to Rushworth,[49] the first test (cash–flow insolvency) relates to the inability to pay debts, which is stricter as it is

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40 2014 (2) SA 518 (SCA) ('*Boschpoort'*) para 16.
41 Section 128(1)(*f*)(i–ii) of the 2008 Act.
42 F H I Cassim (ed), M F Cassim, R Cassim et al *Contemporary Company Law* 2 ed (2012) 862.
43 (2012) ZAWCHC 33 ('*Gormley*').
44 Ibid para 11.
45 '*Boschpoort*' supra note 40.
46 2020 (2) SA 93 (SCA) ('*Murray*').
47 Ibid para 31.
48 *Boschpoort* supra note 45 para 19.
49 Rushworth op cit note 34 at 377.

quite clear from the companies' inability to pay its debts from its financial resources.[50] The second test (balance–sheet insolvency) is where the liabilities exceed the assets.[51] There may be other aspects that prevent a proper evaluation. For example, whether a guarantee of another company would be treated as a liability.[52] The test pertains to a daily record of the financial affairs which is not commonly organised by businesses and suggests that where the sustainability of a company is questioned, directors must prepare balance–sheets regularly.[53]

Moreover, when a company first experiences financial distress, it would be eligible to apply for business rescue according to *Welman v Marcelle Props*,[54] whereby 'distressed' relates to an 'ailing' company and not the 'terminally ill' nor the 'chronically ill'.[55]

In *Merchant West Workings Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd*[56] Kgomo J states that, the difference with the 2008 Act and the 1973 Act is that a company that is already insolvent should instead be liquidated rather than placed under business rescue proceedings.[57]

Rogers J in *Tyre Corporation Cape Town (Pty) Ltd v GT Logistics (Pty) Ltd*[58] opposes the above judgment by stating that

> '[the definition of] financially distressed under section 128(1) of the 2008 Act creates a threshold. Current commercial or factual insolvency is not a pre–condition. This is understandable. But it does not follow that, because the company is already financially distressed, it can no longer be subject to business rescue. This interpretation would be inconsistent with s 5(1)[59] together with s 7(d)[60] and (k)[61] as it would oblige the court to liquidate a company even though there might be a reasonable prospect of rescue.'[62]

Furthermore, he expresses the view that a company that is factually insolvent, yet commercially solvent, should be regarded as being in financial distress within the meaning of s

50 Ibid.
51 Ibid.
52 Ibid.
53 Ibid.
54 (2012) ZAGPJHC 32 ('*Welman*').
55 Ibid para 2.
56 (ZAGPJHC) unreported case no 13/12406 of 10 May 2013 ('*Merchant West*').
57 Ibid para 8.
58 2017 (3) SA 74 (WCC) ('*Tyre Corporation*').
59 According to s 5(1) of the 2008 Act, the Act must be interpreted and applied to give effect to purposes of s 7.
60 Section 7(d) of the 2008 Act, reaffirm the business to achieve economic and social benefits.
61 Section 7(k) of the 2008 Act, provide for efficient rescue of the financially distressed company by balancing all interests of stakeholders involved.
62 *Tyre Corporation* supra note 60 para 15.

128(1)(*f*)(ii)[63] and relied on the SCA judgement in *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd*,[64] where the court found no reason to treat factual insolvency indifferently and considered current commercial insolvency as financial distress.[65]

Cassim[66] submits that the elementary question in deciding financial distress is whether the company's business is 'viable' and in assessing factual insolvency, courts are required to adopt a holistic approach in evaluating whether or not the company is insolvent or approaching insolvency.[67] The 'twin test' of cash–flow insolvency (commercial insolvency) and balance–sheet insolvency (factual insolvency) should be determined side by side.[68]

In general, the requirement for financial distress is an upgrade from the 1973 Act, which required proof of the company already being insolvent. Nevertheless, the financial planning of a company is usually carried over to the subsequent year, and it is submitted that for a business to be preemptive and guard against financial risks, or imminent crisis, the anticipation of these events occurring must be changed from six months to twelve months before exercising claims.[69] This is particularly relevant considering the ongoing (Covid–19) pandemic at present.

Furthermore, Loubser[70] argues that, a consequence due to the uncertainty around the determination of financial distress is when directors run the risk of personal liability when their level of understanding the company's financial distress does not match the court's finding. In fear of their judgement resulting in this, they consider liquidation.[71] Levenstein[72] suggests that, the BOD should consider the nomination of a BRP to assist with a 'pre–assessment', which is an investigation into whether the company is in fact in financial distress and has a reasonable prospect of success as per the 2008 Act.[73]

In terms of s 129 (7) of the 2008 Act, there is a statutory obligation on the board to send a notification to all stakeholders once they have established that they are financially

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63 Ibid para 16.
64 2013 (4) SA 539 (SCA) ('*Oakdene Square* SCA').
65 Ibid para 7.
66 M F Cassim 'South African Airways makes an emergency landing into business rescue: Some burning issues' (2020) 137(2) *SALJ* 201.
67 Ibid.
68 Ibid.
69 A Loubser *A Some Comparative Aspects of Corporate Rescue in South African Company Law* (unpublished PhD thesis, University of South Africa, 2010) 58.
70 A Loubser 'The business rescue proceedings in the Companies Act of 2008: Concerns and questions (part 1)' (2010) *TSAR* 506.
71 Ibid.
72 E Levenstein 'Business rescue in South Africa: shortcomings, suggestions and possible amendments to Chapter 6 of the 2008 Companies Act' (2018) *CR* 10.
73 Ibid.

distressed. If they do not pursue the resolution after they have reasonable grounds to do so, they must provide notification to the affected persons on their reasons.[74] This provides the stakeholders with an opportunity to make a court application. In the absence of a moratorium, s 129 (7) is seen as unfavorable (in practice) as it could lead to creditors demanding payments, suppliers cancelling business, labour actions instituted by employees, together with trade unions, and this is likely to end up in a possible and immediate liquidation.[75]

The legal consequence of a moratorium[76] and post–commencement finance[77] are discussed in chapter 4. On the contrary, if they do not abide by the provision, they are accountable for the losses sustained.[78] For example, where a shareholder continues to do business with the financially distressed company (unaware of its status) and is left with no security as a result.[79] Consequently, the board may be regarded as 'reckless' and charged with gross negligence.[80]

However, a company would be protected under a civil claim in terms of s 22(1) and s 218(2) if they were meticulous in understanding whether or not the company is financially distressed, and on this understanding, optioned not to send the notification in good faith.[81] Hence, clarity on the requirement is necessary to avoid further complications.

(ii) There must be a reasonable prospect of rescue

Similarly, the above requirement and 'a reasonable prospect of rescue' are essential recovery–requirements of the business rescue regime for both commencement by court order[82] and a board resolution.[83] In the 2008 Act the term 'reasonable prospect' is not defined, and this is unfortunate considering the uncertainty experienced with the concept of a 'reasonable

74 See s 129(7) of the 2008 Act.

75 Loubser op cit note 69 at 66. See also C Els, M Yudaken, L Kahn et al 'Webinar: Sustaining businesses in challenging times' *Webber Wentzel* 10 June 2020 available at *https://www.webberwentzel.com/News/Pages/webinar-sustaining-businesses-in-challenging-times.aspx*, accessed on 20 June 2020.

76 See s 133 of the 2008 Act.

77 See s 135 of the 2008 Act.

78 See s 218(2) of the 2008 Act.

79 D Kotzé 'Catch 22 Directors' duties under s 129(7) of the Companies Act (2013)' *De Rebus* available at *http://www.saflii.org/za/journals/DEREBUS/2013/84.html*, accessed on 12 August 2020.

80 See s 22(1) of the 2008 Act.

81 E Levenstein *An Appraisal of the New South African Business Rescue Procedure* (published LLD thesis, University of Pretoria, 2015) 322.

82 See s 131(4)(*a*)(iii) of the 2008 Act.

83 See s 129(1)(*b*) of the 2008 Act.

probability' under the 1926 and 1973 Acts.[84] It was, therefore, the task of the courts to subsequently interpret the meaning of 'reasonable prospect.'

The *Swart v Beagles Run Investments*[85] case was decided by Makgoba J and is reportedly the first case to apply the principles since the promulgation of the 2008 Act. The application was presented by an affected party (Mr Swart, the sole director and its only shareholder).[86] The court determined the financial distress of the company, concluding it was severely insolvent and that the argument of factual insolvency could not be sustained based on the financial statements presented.[87]

The court also accepted that the exotic animal values were exaggerated, and that the application lacked good faith.[88] On determining whether there was a 'reasonable prospect', the judge sought guidance from the 1973 Act, considering the company must continue to be a 'successful concern'.[89] Makgoba J defines this concept as continuing business usually and realising a better return for the creditors. Makgoba J was not convinced that the company demonstrated a reasonable prospect, and by the discretion of the court[90] rejected the application, considering the financial burden that the applicant continuously caused the company to incur.[91] Makgoba J concluded that the interests of the creditors should prevail after balancing both interests.[92]

In *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd*,[93] the application was brought by a creditor who argued that the respondent company would be able to continue successfully trading if it obtained the necessary funding to complete construction of the luxury hotel.[94] Eloff J dealt with the 'reasonable prospect' requirement by contrasting the interpretation to 'reasonable probability', correctly stating that the threshold is

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84 E P Joubert '"Reasonable possibility" versus "reasonable prospect": Did business rescue succeed in creating a better test than judicial management?' (2013) *THRHR* 553.

85 (2011) ZAGPPHC 103 ('*Swart*').

86 Section 131(4) of the 2008 Act.

87 *Swart* supra note 87 paras 30–31.

88 Ibid para 33.

89 Ibid para 25; s 427(1) of the 1973 Act – what must be reasonably probable is that the company is viable and capable of ultimate solvency. See also *Millman NO v Swartland Huis Meubileerders (Edms) Bpk* 1972 (1) SA 741 (C) at 774, and that it will, within a reasonable time, become a successful concern. See also *Porterstraat 69 Eiendomme (Pty) Ltd v PA Venter Worcester* (Pty) Ltd 2000 (4) SA 598 (C) at 616.

90 *Swart* supra note 87 para 37.

91 Ibid para 40.

92 Ibid para 41.

93 2012 (2) SA 423 (WCC) ('*Southern Palace Investments*').

94 Ibid para 6.

lower, and how the approach on the 2008 Act is aimed on facilitating business rescue rather than liquidation. [95]

Eloff J further deliberated on the 'vague and uninformative' plan and stated that the reasons for the company's downfall and possible recovery solutions must be advanced, and set out the following objectively ascertainable factors that they could prove to satisfy the requirement of the company being sustainable:

> (i) 'The likely costs of rendering the company able to commence with its intended business, or to resume the conduct of its core business;
>
> (ii) The likely availability of the necessary cash resource in order to enable the ailing company to meet its day–to–day expenditure, once its trading operations commence or are resumed. If the company will be reliant on loan capital or other facilities, one would expect to be given some concrete indication of the extent thereof and the basis or terms upon which it will be available;
>
> (iii) The availability of any other necessary resource, such as raw materials and human capital; and
>
> (iv) The reasons why it is suggested that the proposed business plan will have a reasonable prospect of success.'[96]

The court could also not ascertain from the lack of concrete evidence whether a better return for creditors would emerge and that speculation thereof was insufficient.[97] In *Koen v Wedgewood Village Golf & Country Estate (Pty) Ltd*,[98] the purchasers of an erf in Gqeberha brought this application. The respondent company was developing a golf estate on that land. However, it could not continue due to lack of investment and did not provide particulars relating to potential investors that would provide the necessary funding. Binns-Ward J stated that, providing clarity on the objective of either continuing to operate on a solvent basis or achieving a better return for creditors in the interim would be required, as this may also assist in the task of the BRP ascertaining the prospects of success and whether the court should appoint one for an investigation. This must be apparent in its founding documents.[99] Binns-Ward J concurred with the observations and guidelines advanced by Eloff J in *Southern Place*.[100]

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95 Ibid paras 21–22.
96 Ibid para 25.
97 Ibid.
98 2013 (1) SA 191 (WCC) ('*Koen*').
99 Ibid para 17.
100 *Southern Palace Investments* supra note 95.

In *A G Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd*[101] the distressed company was commercially insolvent, their liabilities amounted to R 225 million, exceeding their assets valued at R 60 million. Consequently, liquidation proceedings and a failed compromise of debts had preceded this business rescue application. Coetzee J stated that, the reasonable prospect requirement must be satisfied regardless of whether ss 131(4)(*a*)(i–iii) are relevant.[102]

> 'An interpretation that the second requirement only needs to be present if sub–section (iii) is relied upon would be illogical: On such an interpretation a financially distressed company and a company which failed to pay its debts could be placed under rescue irrespective of the prospects of their recovery. Yet, a company which requires rescue for other just and equitable reasons of a financial nature can only be placed under rescue if there is a reasonable prospect of its recovery.'[103]

Traverso DJP passed judgment on the consolidated matters of *Gormley v West City Precinct Properties (Pty) Ltd*[104] and *Anglo Irish Bank Corporation Ltd v West City Precinct Properties (Pty) Ltd*.[105] In this case the respondent, West City, was indebted for R 219 million to the bank. The court found that West City was not in financial distress as per the provisions, hence, the Chapter 6 provisions could not apply. Additionally, the company was already insolvent and would need a breathing space of approximately 3–5 years to pay off the debts.

Traverso DJP stated in this regard that, 'a measure of certainty is needed in the commercial world. Creditors cannot be left in a state of flux for an indefinite period.'[106] Moreover, the court found there was no reasonable prospect. Gormley's argument on suspending the R 219 million loan for 3–5 years and sale of the sectional title units in the ordinary course, as opposed to a forced sale providing a better return for creditors was inadequate.[107]

In *Nedbank Ltd v Bestvest 153 (Pty) Ltd, Essa and Another v Bestvest and Another*,[108] Gamble J agreed with the interpretation by Eloff J in *Southern Place*[109] and was concerned on the sufficiency of evidence for a reasonable prospect. Gamble J accordingly states the reasons of commercial insolvency: the reasonable expense of completing the building; the possibilities

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101 2012 (5) SA 515 (GSJ) ('*A G Petzetakis*').
102 Ibid para 14.
103 Ibid para 15.
104 *Gormley* supra note 43.
105 (2012) ZAWCHC 33 ('*Anglo Irish Bank*').
106 Ibid para 11.
107 Ibid paras 10–11.
108 2012 (5) SA 497 (WCC) ('*Nedbank Ltd v Bestvest*').
109 *Southern Palace Investments* supra note 95.

of gathering funds to complete it; and how it plans to attain commercial viability thereafter is the preferred standard.[110]

Employees of Solar Spectrum Trading 83 (Pty) Ltd v AFGRI Operations Ltd; In Re: AFGRI Operations Ltd v Solar Spectrum Trading 83 (Pty) Ltd,[111] was the first case brought in terms of s 131(4) by employees. Kollapen J considered the factors by Eloff AJ in *Southern Palace*[112] and agreed the rule of each case is dealt with on its own merit. Kollapen J remarked that whilst a reasonable prospect must be proved, consideration must be made for affected parties in the court application in respect to their knowledge of the company.[113]

The court contrasted the availability of information between a shareholder and an employee concerning financial performance and status of the company. If the test for satisfying the requirement of reasonable prospect is more demanding for an affected party, the court must take this into account.[114] Kollapen J also mentioned that the condition of an affected party producing a BR plan on the proceedings to satisfy the requirement of reasonable prospect is not envisaged in the Act. A BRP conducts that responsibility.[115] Additionally, Kollapen J also distinguished the term 'prospect' as relating to something that is certain. Naturally, a prospect is future–looking and reliant upon several variables, and there is a risk attached, making the future incapable of a precise prediction.[116]

Van der Merwe J in *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd*[117] agreed that speculations and uncertain averments were insufficient, and a factual foundation is necessary. However, Van der Merwe J remarked that Eloff AJ placed 'the bar too high' in *Southern Palace*.[118] For context, Van der Merwe J noted 'prospect' as:

> 'An expectation may come true or it may not. It therefore signifies a possibility. A possibility is reasonable if it rests on a ground that is objectively reasonable. In my judgment a reasonable prospect means no more than a possibility that rests on an objectively reasonable ground or grounds.'[119]

Furthermore, Van der Merwe J refers to the primary philosophy of Chapter 6 of the 2008 Act, which seeks to avoid the adverse social and economic effects that were

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110 *Nedbank Ltd v Bestvest* supra note 108 para 43.
111 (NGC) unreported case no 6418/2011, 18624/2011 and 66226/2011 of 16 May 2012 ('*Solar Spectrum*').
112 *Southern Palace Investments* supra note 95.
113 *Solar Spectrum* supra note 111 para 16.
114 Ibid para 17.
115 Ibid para 18.
116 Ibid para 33.
117 2013 (1) SA 542 (FB) ('*Propspec Investments*').
118 *Southern Palace Investments* supra note 95; *Propspec Investments* supra note 117 para 11.
119 *Propspec Investments* supra note 117 para 12.

experienced in the 1973 Act.[120] Van der Merwe J states that the guidelines by Eloff AJ are equivalent to obliging proof of a probability and this unreasonably limits the chances of business rescue proceedings.[121]

In *Zoneska Investments (Pty) Ltd t/a Bonatla Properties (Pty) Ltd v Midnight Storm Investments 386 Ltd,*[122] Midnight Storm was the owner of an erf where a luxury hotel was commencing construction but ceased due to lack of funds and the applicant, Bonatla (a creditor), believed the development could result in a better outcome for shareholders than liquidation.[123]

The respondent company was factually– and commercially insolvent and it could not pay its creditors because the hotel was incomplete as to generate income. Their only asset was valued at R 120 million against a debt of more than R 344 million.[124] The court quoted the Oxford English Dictionary meaning of 'prospect' as both the 'the possibility or likelihood of some event in the future occurring. A possibility is a thing that may ensue, and likelihood is the fact of something being likely, probable.'[125] Stelzner AJ held that, the question must be:

> 'Whether the applicant, on the common facts of the case and where there is a real dispute of facts, on the respondent's version, has shown that there is a reasonable prospect of rescuing the company in the sense that acceptance and implementation of the plan, upon which the applicant relies, has a possibility, based on objective facts, that it would result in a better outcome for creditors than liquidating the company.'[126]

Accordingly, the application was dismissed. In *Oakdene Square Properties*[127] the appellants in this matter sought to overturn the court *a quo*'s decision to liquidate the first respondent (Bothasfontein farm).[128] The affected parties included: Oakdene Square Properties (creditors); Educated Risk Investments (shareholders); and the Theodosiou brothers.

The brothers are the trustees of the MJF Trust which they asserted, previously owned the forty per cent shares in the company now held by Educated Risk Investments.[129] The respondents included: Bothasfontein farm; Nedbank; and Imperial Holdings. Nedbank and

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120 Ibid para 13.
121 Ibid para 15.
122 2012 (4) All SA 590 (WCC) ('*Zoneska*').
123 Ibid para 12.
124 Ibid paras 14–15.
125 Ibid para 29.
126 Ibid para 56.
127 *Oakdene Square* SCA supra note 64.
128 2012 (2) All SA 433 (GSJ) ('*Oakdene Square* HC').
129 *Oakdene Square* SCA supra note 64 para 2.

Imperial each had a thirty per cent of the shares in the company, and they were each owed R 7.5 million by the company in the form of a shareholder's loan.[130]

The appellants' core argument was that forcing a sale in execution would not be beneficial for the creditors and shareholders as the asset realisation value would be approximately R 120 million. In the ordinary course, the true market value on sale, according to experts, could realise between R 300 million to R 350 million.[131] The respondents rejected this valuation and relied on their expert advice that the immovable assets worth were at least R 129 million and the liabilities of the company adding up to R 75 million, appearing to be factually insolvent.[132] Accordingly, the appellants advanced their application based on business rescue yielding a better return than liquidation. They relied on the following grounds:

(a) The immovable property could realise a better value by a business rescue practitioner as opposed to a liquidator;

(b) A business rescue practitioner's fees are lower than a liquidator; and

(c) Nebdbank's secured claim could be discharged by the sale of the two Kyalami erven (which are part of Bothasfontein farm), allowing the practitioner to trade with the other hectares of the farm.[133]

Consequently, it was unable to pay the judgment debt in favour of Nedbank which meant, it was also commercially insolvent for liquidation and financially distressed in terms of s 131(4)(*a*)(i).[134] With regard to the objectives of the business rescue plan in terms of s 128(1)(*b*)(iii), the primary goal would be to ensure that the company will continue on a solvent basis and a secondary (an alternative) goal is to facilitate a better return for creditors and stakeholders than immediate liquidation.

The issue on hand was whether the requirement of 'rescuing the company' as contemplated in s 131(4)(*a*) is satisfied, it is clear from the beginning that the company can never be saved from immediate liquidation and that the only option is liquidating the company for a better return.[135] Consequently, Brand AJ endorsed that s 128(1)(*b*) defines 'rescue' and 'rehabilitation' to mean the success of one of the two objectives: (a) to return the company to solvency; or (b) to offer a better outcome for creditors and shareholders than

130 Ibid para 4.
131 Ibid para 15.
132 Ibid para 16.
133 Ibid para 17.
134 Ibid para 7.
135 Ibid para 23.

what they would receive over liquidation. The business rescue plan in terms of s 131(4) would be qualified where one of the two objectives is achieved.[136]

The requirement of whether there was a reasonable prospect of rescue was addressed by Claassen J in the court *a quo*, and he agreed with Eloff AJ on the point that it required something less than the recovery requirement of its predecessor. Additionally, Claassen J stated that a court might exercise discretion to grant the order if the facts indicate a 'reasonable possibility of the company being rescued.'[137] In essence, Brand AJ believes it requires more than a mere *prima facie* case or an arguable possibility. He further states that

> It must be a *reasonable* prospect which means that it must be a prospect based on reasonable grounds. A mere speculative suggestion is not enough. Moreover, because it is the applicant who seeks to satisfy the court of the prospect, it must establish these reasonable grounds in accordance with the rules of motion proceedings which, generally speaking, require that it must do so in its founding papers […] it will be neither practical nor prudent to be prescriptive about the way in which the appellant must show a reasonable prospect in every case.[138]

Brand AJ concluded that the appellants' argument of a BRP realising a better value for their assets and the liquidator's fees exceeding the BRP to be mere speculation, as the fees of the liquidator are calculated as a percentage of the assets of the company. In contrast, BRP's fees are based on a daily rate.[139] The court addressed the problem with the valuation of the erven and found that even upon sale, the debt owed to Nedbank would not be discharged because of the interest accumulating and besides, there would be no income to pay outstanding debts, including the BRP's remuneration.[140]

With regard to the appellants' argument on the sale of the immovable property after payment to creditors resulting in a cash surplus,[141] Brand AJ was not convinced that this would establish a 'business rescue' within the meaning of s 128(1)(*b*)(iii). He remarked that a company which existed merely on the bank for cash had lost its credibility. Furthermore, the requirement could only be satisfied where there was a real possibility that the bank's money would revive the company's business and based on the irreconcilable differences between the

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136 Ibid para 26.
137 Ibid para 18.
138 Ibid paras 29–30.
139 Ibid para 34.
140 Ibid para 36.
141 Ibid para 39: 'This outcome, so the argument went, would terminate the commercial insolvency of the company. It appears to me, this can be regarded of any company which is commercially insolvent, but factually solvent.'

shareholders, that possibility can be excluded in this case. Brand AJ concluded that the liquidation of the company was the preferred route.[142]

In *Newcity Group (Pty) Ltd v Allan David Pellow*,[143] there was an appeal against Van Eeden AJ's judgment in the high court for the final liquidation of Crystal Lagoon Investments 53 (Pty) Ltd. The appellant was a single shareholder of the company[144] and based its application on the foundation that Crystal Lagoon was financially distressed, and that it was just and equitable to place the company under business rescue; and that there was a reasonable prospect of rescuing the company by placing it under the supervision of business rescue.

The court *a quo* accepted Crystal Lagoon being in financial distress but regarded the attachment of a BR plan in its founding papers to prove reasonable prospect as unnecessary. The mere advancement of facts that would materialise the likelihood of continuation on a solvent basis and a better return for creditors instead of liquidation would have sufficed in the court exercising discretion for granting the relief. The court held that the company could be sold as a 'going concern' and to balance the parties' rights and interests, it granted a final winding–up order.[145]

The main issue on appeal was therefore whether Newcity had shown a reasonable prospect of rescuing Crystal Lagoon.[146] Maya AJ held that as per the explicit wording of these provisions, a court may not grant an application for business rescue unless there is a reasonable prospect for rescuing the company. In answering the question, a court uses its discretion in a broad sense, it makes a value judgment, and where a higher court disagrees with such decision, it is bound to intervene.[147] Maya AJ accepted the meaning on 'reasonable prospect' as put forward in *Oakdene Square Properties*[148] and *Propspec Investments*[149] and subsequently dismissed the appeal.[150]

In a recent high court case, *Ziegler South Africa (Pty) Ltd v South African Express Airways SOC Ltd*,[151] the creditor contended that despite the reliance of the state–owned company on taxes and government–guaranteed debt, there is a chance of profitable trading if

142 Ibid.
143 (2014) ZASCA 162 ('*Newcity Group* SCA').
144 Ibid paras 1–2.
145 Ibid para 10.
146 Ibid para 11.
147 Ibid para 15.
148 *Oakdene Square* SCA supra note 64
149 *Propspec Investments* supra note 119.
150 *Newcity Group* supra note 145 para 23.
151 2020 (4) SA 626 (GJ) ('*Ziegler*').

the company is managed correctly.[152] It argued its significant assets and provisioned flights to major cities and neighbouring countries.[153] The court held that, the applicant had met the threshold of illustrating a reasonable prospect as required by s 131(4).[154] Subsequently, three months after this judgment, the appointed BRPs applied for the airline's provisional liquidation, stating that the airline had no reasonable prospects of being rescued after the state did not extend any post–commencement funding to the process.[155]

With regard to whether a reasonable prospect is a minimum threshold that would apply to all applications, either board resolutions or court applications, the punctuation in the Act suggests that perhaps the requirement would apply to s 129(1) as a minimum requirement that needs to be met before business rescue can commence and that a court application in terms of s 131(4) would need to satisfy the minimum of being in financial distress.[156] The alternative in this instance for 'reasonable prospect' would be whether the application is 'otherwise just and equitable for financial reasons.'[157]

The word 'prospect' seems to rehash the uncertainty experienced under judicial management as the word is synonymous to meaning a 'possibility' or a 'probability'. Therefore, this problem could have been avoided if the term 'possibility' was used instead.[158] Section 128 of the 2008 Act does not define 'reasonable prospect of rescuing the company' as well as the term 'rehabilitation', and this is inadequate considering the old Acts, where these concepts were problematic.[159]

Before a board may adopt a voluntary application, they must have reasonable grounds to believe the company is financially distressed,[160] and there appears to be a reasonable prospect of rescuing the company.[161] The meaning of 'reasonable grounds' is also not defined in the Act. However, it seems to show that directors must believe that the requirements are in existence and they must have good reasons for this belief when voting for a resolution to commence business rescue proceedings and is thus an objective test.

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152 Ibid para 52.
153 Ibid para 53.
154 Ibid para 63.
155 T Tshwane 'Affected parties have until June 9 to challenge SA Express liquidation' *Money Web* 28 April 2020 available at *https://www.moneyweb.co.za/news/south-africa/affected-parties-have-until-june-9-to-challenge-sa-express-liquidation/*, accessed on 30 April 2020.
156 R S Bradstreet 'Business rescue proves to be creditor–friendly: CJ Claassen J's analysis of the new business rescue procedure in *Oakdene Square Properties*' (2013) 130 *SALJ* 48; see also a 131(4)(*a*)(i) of the 2008 Act.
157 Ibid. See also s 131(4)(*a*)(iii) of the 2008 Act.
158 Loubser op cit note 69 at 59.
159 Joubert op cit note 84 at 553.
160 Section 129(1)(*a*) of the 2008 Act.
161 Section 129(1)(*b*) of the 2008 Act.

The phrase refers to the company's individual conditions at the time of the resolution, which will be known to the board, and is thus a subjective test. Loubser submits that the test should embrace a subjective and objective approach for consistency and to conform to the general standards set out for the conduct of directors in the 2008 Act.[162]

According to Braatvedt, upon determining reasonable prospect, an objective or subjective test must not be applied rigidly and the feasible approach would be a subjective test on the firm and proven objective business facts.[163] It is commonly followed that the assessment of this requirement must be viewed through the lens of a 'reasonable businessman'.[164] The query would then be 'whether a reasonable, experienced businessman in that particular field would conclude that there is a reasonable prospect of success given the objective proved and not disputed facts.'[165]

Depending on the type of application, it is submitted that the reasonable prospect requirement would be interpreted accordingly, founded on the information readily available to the parties bringing an application.[166] The imbalance is that directors have more knowledge of the financial status of their company, and affected parties (employees and shareholders) do not.[167]

As a result, *Southern Palace Investments*[168] demonstrates the incorrect procedure where an application required a detailed BR plan to satisfy that there is a reasonable prospect, following a 'checklist' provided by Eloff AJ. Essentially, such a plan is only available after a BRP is appointed to devise a workable business plan after it has been voted on.[169]

In the consequent judgments, Eloff AJ's 'checklist' was regarded 'as placing the bar too high'.[170] Delport argues that such requirements place an illogical high benchmark.[171]

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162 Loubser op cit note 69 at 56.

163 K Braatvedt 'Is the test for reasonable prospect objective or subjective?' available at *https://www.tma-sa.com/info-centre/item/223-is-the-test-for-reasonable-prospect-objective-or-subjective.html*, accessed on 10 June 2020.

164 Ibid.

165 Ibid.

166 Joubert op cit note 84 at 545. See also P Delport, P M Meskin (ed) & Q Vorster et al *Henochsberg on Companies Act 71 of 2008* (2016) 451–452; and 463–464, for a discussion of the dual gateway and the burden of proof of the recovery requirement and some uncertainty that might exist depending on the various stages of the application and the burden of proof.

167 Joubert op cit note 84 at 545. See also Delport et al op cit note 168 at 464; *Solar Spectrum* supra note 113 para 18.

168 *Southern Palace Investments* supra note 95.

169 Joubert op cit note 84 at 577; see s 146(*d*) of the 2008 Act.

170 *Propspec Investments* supra note 119 para 11; *Newcity Group, China Construction Bank Corporation Johannesburg Branch v Crystal Lagoon Investments 53 (Pty) Ltd* (2013) ZAGPJHC 54 ('*Newcity* HC') para 14.

Accordingly, it may be better for a BRP to deal with such questions instead of placing the expectation on the applicant to prove the requirements at the time the application is heard in court, which he regards would be 'to place the horse before the cart'.[172] Furthermore, such an expectation could signal the 'death knell' of business rescue in South Africa, making it ineffective like judicial management. [173]

It is submitted that *Oakdene Square Properties*,[174] the landmark case which indicated that reasonable prospect must be proved on reasonable grounds, is not helpful. There are suggestions that inquires must be made on whether: a business exists; its business contributions; and its business model. It is agreed that for a company to have a reasonable prospect of success, it must make commercial sense.[175]

Joubert and Delport submit that in *Propspec Investments (Pty) Ltd*,[176] Van der Merwe's 'reasonableness approach' to a 'reasonable prospect' is the most realistic test that could be the solution to issues experienced in its interpretation.[177] Essentially, this requirement is to safeguard that companies which are not economically sustainable, are liquidated rather than placed under business rescue.[178]

Accordingly, although the cases discussed above interpreted the 'reasonable prospect' of rescuing the company in the context of s 131(4) of the 2008 Act and not in terms of s 129(1), the meaning would apply to both provisions.[179]

(iii) Rescuing the company to continue a solvent basis; or a better return for creditors or shareholders compared to a liquidation

Section 128(1)(*h*) of the 2008 Act defines 'rescuing the company' as achieving the goals set out in the definition of business rescue in terms of s 128(1)(*b*)(iii) of the 2008 Act.[180] Thus, s

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171 Y Mti *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd: A case discussion of the Supreme Court of Appeal decision with reference to the reasonable prospect requirement set out in the Companies Act 71 of 2008* (unpublished LLM, University of Johannesburg, 2015) para 5.1. See also Delport et al op cit note 168 at 451.

172 Mti op cit note 173 at para 5.1. See also Delport et al op cit note 168 at 468.

173 Ibid.

174 *Oakdene Square* SCA supra note 64

175 Braatvedt op cit note 163.

176 *Propspec Investments* supra note 119.

177 Delport et al op cit note 168 at 468. See also Joubert op cit note 84 at 563.

178 Cassim et al op cit note 42 at 865.

179 Delport et al op cit note 168 at 460.

180 According to s 128(1)(*b*) 'business rescue' is defined as 'proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for – (i) the temporary supervision of the company and of the management of its affairs, business and property; (ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and (iii) the

128(1)(*h*) of the 2008 Act must be read together with s 128(1)(*b*)(iii) of the 2008 Act.[181] In the event whereby there is no clear prospect of the company continuing to operate on a solvent basis, or being restored to solvency, our courts have not been able to reach a consensus on whether business rescue proceedings may be used to secure a better return for creditors or shareholder.[182]

Joubert contends that the phrase 'reasonable prospect for rescuing the company to become a successful concern' must be read as a complete unit. Thus, this interpretation, in its entirety, needs more clarity. The primary objective is that the company will continue its business on the basis that it can be restored to a sound financial position after the plan is implemented.[183] The secondary (or alternative) is that once implemented, the creditors stand to receive a better dividend than they would receive if the company is liquidated. The primary and secondary goals are both viewed as a successful business rescue. [184]

In *Southern Palace Investments*,[185] the court held that adequate information must be presented to prove the objective for a better return for creditors and the terms it is based on and that a lack thereof is mere speculation that immediate liquidation was not a better option than business rescue.[186]

Likewise, in terms of s 128(*b*)(iii), the company's continued existence on a solvent basis is not the sole objective of business rescue as an alternative objective of stakeholders receiving a better return compared to what they would have received if the company was liquidated, is equally a successful concern.[187] The latter is a substitute for the successful rescue of an ailing company, as confirmed in the SCA case of *Oakdene Square Properties*.[188]

(iv) Non–payment of amounts due in respect of contractual or statutory obligations

If an applicant (under a compulsory application) is unable to establish financial distress, they may then base an application for a business rescue order on the non–payment by the company

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development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.'

181 *Oakdene Square* SCA supra note 64 para 22.
182 Ibid.
183 Joubert op cit note 84 at 544.
184 Ibid.
185 *Southern Palace Investments* supra note 95.
186 Ibid para 25.
187 *A G Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd* 2012 (5) SA 515 (GSJ) para 12.
188 *Oakdene Square* SCA supra note 64 paras 23–26.

of amounts due in respect of contractual or statutory obligations relating to employment matters, whereby even a single missed payment may suffice.[189] Accordingly, Cassim submits that a failure to pay income tax deducted from employees or contributions to the Unemployment Insurance Fund ('UIF'), or to make payments to a medical aid, falls within the scope and ambit of s 131(4)(*a*)(ii) of the 2008 Act.[190]

Moreover, Loubser believes that, non–payment should occur over a specified minimum period or frequency before it constitutes a ground for rescue proceedings, and at least two consecutive payments should be missed.[191] It is further noted that this subsection is not practical for modern companies who depend on programs, systems and banks to make necessary payments.

(v) Just and equitable for financial reasons

The second alternative available for a compulsory application is whether the court regards it as otherwise just and equitable 'for financial reasons'.[192] Loubser further argues that, interpretational difficulties will persist based on its vagueness and that this pre–condition be removed. Essentially, by including the circumstances of what a financially distressed company looks like, it may assist in interpreting the phrase 'financially distressed'. This clarification will also assist applicants (under a compulsory application) who do not have easy access to the financial information that is required, in order to satisfy the court on this requirement when applying for an order to commence the procedure.[193]

In conclusion, when dealing with a distressed company, the following factors may assist the courts in their determination: (1) the business and continuing sources of income; (2) the value of the brand and perception in the marketplace;[194] (3) the total dedication of the current management and their communication with affected parties;[195] (4) the accessibility of post–commencement finance;[196] (5) how new technology results in new markets and products available to company;[197] and (6) the benefit of cancelling or suspending obligations (a

189 Section 131(4)(*a*)(ii) of the 2008 Act.
190 Cassim et al op cit note 42 at 874.
191 Loubser op cit note 70 at 506.
192 Section 131(4)(*a*)(iii) of the 2008 Act.
193 Loubser op cit note 70 at 506.
194 Braatvedt op cit note 163.
195 Ibid.
196 Ibid.
197 Ibid.

moratorium and the socio–economic factors, including government spending and the demands of the industry it operates).[198]

198 Ibid.

CHAPTER 3

I DISCUSSION OF VOLUNTARY BUSINESS RESCUE WITH SPECIFIC REFERENCE TO THE SOUTH AFRICAN AIRWAYS (SOC) LIMITED CASE

(a) Introduction

The objective of this chapter is to establish if SAA has met the necessary requirements listed in terms of ss 129(1)(*a*) and (*b*), in order to qualify for business rescue. In addition, an overview of the legal consequences of a moratorium and post–commencement finance is also explored. Historically, we have not witnessed any SOE that has experienced the business rescue process until SAA was placed under voluntary business rescue during early December of 2019. Hence, there is uncertainty surrounding the prospects for SOEs under this procedure.

Since 2009, the proverbial warning lights have been flashing for SAA. To date, it has attempted to discharge its debts owed as a result of feeble investments and mismanagement.[1] Conventionally, it has been reliant on the taxpayer for money (from the National Treasury) for bailouts, as with most SOEs, which has safeguarded the airline from being immediately liquidated by creditors.[2] If SAA enters liquidation proceedings, this may trigger the immediate settlement of loans worth billions, which the government is unable to sustain.[3]

On 5 December 2019, a business rescue application was made in terms of s 129(1) of the 2008 Act.[4] This voluntary application observes the first state–owned company to be placed under the procedure.[5] Consequently, Mr Leslie Matuson and Mr Siviwe Dongwana were appointed as joint BRPs.[6]

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1 K Braatvedt 'Is the test for reasonable prospect objective or subjective?' available at *https://www.tma-sa.com/info-centre/item/223-is-the-test-for-reasonable-prospect-objective-or-subjective.html*, accessed on 10 June 2020.

2 H Wasserman 'Explainer: How SAA landed in such a mess' *Business Insider SA* 24 January 2020 available at *https://www.businessinsider.co.za/what-happened-at-saa-2020-1*, accessed on 20 September 2020.

3 Ibid.

4 'Business Rescue of South African Airways (SOC) Limited' available at *https://matusonassociates.co.za/saa/*, accessed on 17 September 2020.

5 M F Cassim 'South African Airways makes an emergency landing into business rescue: Some burning issues' (2020) 137(2) *SALJ* 201.

6 In terms of s 129(3)(*b*) of the 2008 Act; see also 'Business Rescue of South African Airways (SOC) Limited' available at *https://matusonassociates.co.za/saa/*, accessed on 17 September 2020.

SOEs are governed by various legal frameworks, from the Companies Act, Public Finance Management Act 1 of 1999 ('PFMA'), and regulations that apply specifically to the type of the enterprise. SAA is an example of a national SOE, defined as:

> 'A national government business enterprise; or a board, commission, company, corporation, fund or other entity (other than a national government business enterprise) which is established in terms of national legislation; fully or substantially funded either from the National Revenue Fund, or by way of a tax, levy or other money imposed in terms of national legislation; and accountable to Parliament.'[7]

The airline was established on 1 February 1934.[8] Thereafter, Union Airways ('UA') was acquired by the government, making it the first SOE airline in South Africa.[9] The airline is entirely owned by the government, and it is under the supervision of the Department of Public Enterprises ('DPE') as the entrusted shareholder.[10] The business conducted by SAA comprises of transporting passengers, as well as cargo, to local, regional, and international routes, functioning as a national carrier.[11]

Related services are also offered by Mango, SAA Technical ('SAAT'), Airchefs, and the South African Travel Centre ('SATC'), which are exclusively owned subsidiaries of SAA.[12] Furthermore, SA Airlink and SA Express are the feeder airlines to SAA and SAA licenses its airline code to these airlines.[13] However, during business rescue, the license arrangement between SAA and SA Airlink was terminated on 26 March 2020.[14] On 28 April 2020, SA Express was accorded provisional liquidation.[15]

Since its establishment, SAA began providing airline services to thirty destinations.[16] The entity owned a fleet of forty-nine aircraft,[17] and has since, employed 4 708 employees.[18] SAA Voyager, SAA Lounges, and SAA Cargo are divisions of the company.[19]

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7 M H Kanyane, G Houston, G Onuoha et al (2011) *Legislative and regulatory framework review, the role of SOEs in skills development and job creation, SOEs contribution to enterprise and socio–economic development and the qualitative review of the SOEs landscape in South Africa* (Commissioned by the Presidential SOE Review Committee, December) 203.

8 Ibid at 204.

9 Op cit note 4 para 12.1.1.

10 Ibid para 12.1.8.

11 Ibid para 12.1 .2.

12 Kanyane et al op cit note 7 at 205.

13 Op cit note 4 para 12.1.6.

14 Ibid para 12.1.6.1.

15 Ibid para 12.1.6.2.

16 Ibid para 12.1.3.1.

17 Ibid para 12.1.3.2.

18 Ibid para 12.1.7.

19 Ibid para 12.1.4.

(b) Financial distress

In assessing whether a company is financially distressed, a company must either be commercially insolvent, by which the company is unable to pay its debts as they fall due, or is presumably factually insolvent, in that the company's liabilities exceed its assets at any time. In both instances, the time–frame is within the next six months.[20] Likewise, SAA was financially distressed in both cases of this definition at the time the business rescue process was initiated.[21]

To date, the SOE boards have banked on state–guaranteed funding from the National Treasury and have had the option of guarantees to reduce their risk of being financially distressed in terms of s 128(1) of the 2008 Act. An important question discussed here is 'whether business rescue is available to companies that are already insolvent?'. This was after SAA entered into business rescue but were factually insolvent, with its liabilities exceeding its assets by almost R 13 billion.[22]

In assessing whether a SOE is in financial distress, this can be evaluated by 'whether or not the state guarantees can ensure that all the debts due by the company can be repaid, or whether certain creditors will remain unpaid.'[23] The inability to discharge present debts as they fall due and payable is a liquidity issue and the crux of financial distress.[24] As mentioned, this is regarded as commercial insolvency or the 'cash–flow' test.

It is agreed that the test should be determined on the financial standing of the company, holistically concerning the commercial practicality.[25] Furthermore, aside from the financial resources readily available, funding that can be sourced from the sale of assets, loans, or support from a holding or subsidiary company, must be assessed in tandem. Regarding SAA's situation, attention must be paid to the capital obtained from the government (as a shareholder).[26]

As discussed in Chapter 2, a company is financially distressed if, by analysis, it is commercially or factually insolvent. Accordingly, it is essential to also investigate the

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20 Section 128(1)(*f*)(i–ii) of the 2008 Act.

21 Cassim op cit note 5 at 206.

22 Ibid at 201; see also 'South African Airways lost over $700 mln in past 2 years' available at *https://www.dailymaverick.co.za/article/2019-12-02-south-african-airways-lost-over-700-mln-in-past-2-yearsdocuments/*, accessed on 18 July 2020.

23 E Levenstein 'South Africa's state–owned enterprises: prime candidates for business rescue?' (2018) *Without Prejudice* available at *https://www.withoutprejudice.co.za/publication/2018/October/articles*, accessed on 15 July 2020.

24 F H I Cassim (ed), M F Cassim, R Cassim et al *Contemporary Company Law* 2 ed (2012) 864.

25 Cassim op cit note 5 at 206.

26 Ibid.

following scenarios: (1) Would a company that is factually solvent but commercially insolvent be in financial distress? (2) Would a company that is factually insolvent, though commercially solvent, be in financial distress?

In the first instance, it is most common that companies are illiquid as opposed to factually insolvent. For example, a business may have greater assets than liabilities but may struggle to pay debts when they become due because those assets are not easily realisable.[27] In terms of s 128(1)(*f*), the SCA ruled that a company being factually solvent but commercially insolvent is in financial distress.[28]

In the second instance, the contrary has no precedent in the South African courts.[29] The question regarding SAA is whether or not SAA satisfies the test of financial distress on factual insolvency apart from the continuous financial backing from the state to remain commercially solvent? According to Cassim:

> 'A company that is commercially solvent has a greater prospect of satisfying the factual solvency test. But a commercially solvent company may be factually insolvent — for instance, it may have long- term debts which its assets are not reasonably capable of meeting.'[30]

As per the business rescue plan drawn by the BRPs on 16 June 2020 (including the latest amendments), some of the reasons for SAA's financial distress are attributed to the following events: For the past ten years, the airline has incurred major losses and retrospectively, 2011 was one reported year that it had made a profit. Since 2012, the company has amassed debt over R 27 billion in 2019. Due to the exchange rates (between the US $ and the R) doubling from 2011, fuel costs and the airlines leasing costs were altered. Subsequently, a secured long–term debt (in 2012) soared from R 2 billion to above R 13 billion in 2019 (with interest). At the end of March 2017, the final audited yearly commercial statements for SAA indicated a 'material uncertainty relating to going concern' due to the airline already being insolvent with liabilities surpassing assets by R 18 billion. Consequently, the unaudited statements up until 31 March 2019 presented factual insolvency of R 12.9 billion.[31]

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27 Ibid. It could be locked–up capital or property in a real estate development.

28 Ibid. See also *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* 2013 (4) SA 539 (SCA) ('*Oakdene Square* SCA') para 7; *Al Mayya International Ltd (BVI) v Valley of the Kings Thaba Motswere (Pty) Ltd* (2017) JOL 38030 (EL).

29 Ibid. See also *Dale v Aeronastic Properties Ltd* (2016) ZAWCHC 160.

30 Cassim op cit note 5 at at 207.

31 Op cit note 4 paras 12.3.1.1.1–12.3.1.1.7.

SAA suffered increased liquidity problems, and the continuous state–guaranteed funding (or bailouts) frequently relied on by the SOE would be discontinued, but the government confirmed making capital available to enable a radical restructure of SAA. In October of 2019, the airline was grounded by Civil Aviation Authorities for non–compliance, which tainted its reputation with travel agents and customers. In November 2019, an eighty–day industrial action obstructed the cash–flow of the airline.[32]

On 21 November 2019, Solidarity (a trade union) made a compulsory business rescue application after the industrial action. Consequently, several insurers had withdrawn their travel insurance, travel agents had ceased selling tickets with the airline and suggested alternate airlines to customers. Thereafter, the public lost confidence in the airline's sustainability, consequently cancelling flights and demanding refunds.[33]

With regard to management, over the last ten years, the governance issues at SAA has created a high turnover of executive management. There were eight chief executive officers ('CEOs') with five as acting CEOs. There were four chief financial officers ('CFOs') (with one being temporary) and around fifty persons assisting in the Exco for the last ten years and only eight serving for five years. Likewise, SAA had five board chairpersons throughout the same timeframe.[34] Furthermore, the subsidiaries of the airline were dependent on SAA for working capital, and lastly, ticket rates were hampered due to accelerated competition.[35]

In short, SAA experienced illiquidity for the reasons mentioned above. As a result of the substantial loss of income, they were financially distressed due to the inability to pay debts when they fell due.[36]

(c) Reasonable prospect

The purpose of business rescue is to ensure that the rescue is effective enough for a company to recover from the financial difficulty, in a sense that balances the rights and interests of relevant stakeholders.[37] Essentially, business rescue proceedings are not for the 'terminally–' or 'chronically ill'. They are for ailing companies which, at some point, may be salvaged and become solvent again.[38]

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32 Ibid paras 12.3.1.2–12.3.1.2.3.
33 Ibid paras 12.3.1.2.5–12.3.1.2.5.3.
34 Ibid paras 12.3.1.2.6–12.3.1.2.6.3.
35 Ibid paras 12.3.1.2.7–12.3.1.2.8.
36 Ibid para 12.3.2.
37 Section 7(k) of the 2008 Act.
38 *Welman v Marcelle Props 193 CC* (2012) ZAGPJHC 32 para 2.

Since SAA's entrance into business rescue proceedings, its problems have increased due to the ongoing Covid–19 pandemic, which has piloted many global airlines into financial distress. Around March of 2020, the government enforced the suspension of all commercial flights in order to combat the virus during the lockdown period.[39] However, prior the pandemic, for the last five years, the airline has suffered losses around R 23 billion, income declined by R 844 million from November of 2019 up until December of 2020.[40]

As per the business rescue plan drawn by the BRPs on 16 June 2020 (including the latest amendments), the 'proposed restructure' entails, *inter alia*, the government's confirmation to suspend further fiscal support and the advancement of the BR plan where it results in a more feasible national airline.[41] The present corporate structure will not be altered by the proposed restructure.[42] The proposed restructure can only be initiated if the following conditions in the BR plan are satisfied:

On liquidation, as per the commencement date of the BR plan, and according to Price Waterhouse Coopers' ('PwCs') calculation, it is likely that concurrent creditors would have received zero–cents in the Rand as a potential dividend.[43] Accordingly, with business rescue, concurrent creditors are expected to receive an anticipated seven–and–a–half cents in the Rand, as dividend distributed proportionally. Around R 600 million has been allocated to be paid over three years.[44] Lessors are to collect R 1.7 billion as dividend distribution to be paid over three years as well.[45] Post–commencement finance ('PCF') creditors would be paid from the operational capital injection, and their claims are prioritised under the Companies Act.[46] Lenders will receive payment over three years.[47]

Through the Leadership Compact Forum, or the s 189 procedure in terms of the Labour Relations Act 66 of 1995 ('LRA'), employees and SAA's representatives will

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39 A Winning 'South African Airways can still be saved with funding: administrators' *Reuters* 27 May 2020 available at *https://br.reuters.com/article/us-safrica-saa/south-african-airways-can-still-be-saved-with-funding-administrators-idUSKBN2330OB*, accessed on 15 June 2020.

40 In comparison to the same timeframe of the previous year. See C Smith 'SAA rescue process in apparent limbo, with no sign of funding' 5 August 2020 *News24* available at https://www.news24.com */fin24/companies/industrial/saa-rescue-process-in-apparent-limbo-with-no-sign-of-funding-20200805*, accessed on 25 August 2020.

41 Op cit note 4 para 26.1.

42 Ibid para 26.2.

43 Ibid para 26.4.1.1; See also para 19.

44 Ibid paras 26.4.1.2.1.1–26.4.1.2.1.2.

45 Ibid paras 26.4.1.2.1.3–26.4.1.2.1.4.

46 Ibid paras 26.4.1.2.2.1–26.4.1.2.2.2.

47 Ibid para 26.4.1.2.3.1; see also 'Business Rescue of South African Airways (SOC) Limited' 13 July 2020 para 30.3, available at *https://matusonassociates.co.za/wp-content/uploads/2019/12/proposed-amendments-to-the-south-african-airways1938058.8.pdf*, accessed on 17 September 2020.

conclude an agreement should the proposed restructure be implemented, by which the company foresees around one–thousand employees being retained.[48] Also, approximately one–thousand employees will be directed on an interim or 'training lay–off', scheme for twelve months, where the airline will make contributions capped monthly at R 4 650, for employee's UIF, pension, and medical aid. In addition, SAA will offer 'voluntary severance packages' to employees and the remaining employees under s 189 of the LRA procedure will be retrenched. The overall expense for the above is anticipated to be a maximum of R 2.2 billion. Furthermore, new terms and conditions of employment will be deliberated, considering current market conditions. [49]

A receivership was proposed in the BR plan to be in operation from the substantial implementation date. Its purpose would be to shift numerous obligations from affected parties, allowing the airline to continue with a restructured balance–sheet and commercial ventures devoid of the burden of the pre–commencement liabilities. Also, allowing payments to pre–commencement creditors, payments to lenders, and repayments to all creditors, after the notice of substantial implementation is filed.[50]

Thereafter, the projected funding would be for the proposed restructure, from raising operational capital injection to resume operating, to paying retrenchment costs and assistance for the social plan. Also, to recompensing lenders amounts owed[51] and the resolve of SAA as a 'going concern' by fulfilling client bookings or any consequent vouchers that they may receive per the airline's policy.[52] Overall, the funding is divided into immediate–, medium–, and long–term brackets, reinforcing the proposed restructure, as being conditional on the BR plan's implementation.[53]

Theoretically, the reasonable prospect requirement in terms of the 2008 Act is aimed on facilitating business rescue rather than liquidation.[54] Moreover the reasons, as mentioned above, are points advanced in the BR plan for the likelihood of continuation on a solvent

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48 Ibid para 26.4.2.1.

49 'Business Rescue of South African Airways (SOC) Limited' 13 July 2020 para 13, available at *https://matusonassociates.co.za/wp-content/uploads/2019/12/proposed-amendments-to-the-south-african-airways1938058.8.pdf*, accessed on 17 September 2020.

50 Op cit note 4 paras 26.4.3.1–26.4.3.2.3.

51 Ibid para 26.4.4.2.3. See also 'Business Rescue of South African Airways (SOC) Limited' 13 July 2020 para 30.3, available at *https://matusonassociates.co.za/wp-content/uploads/2019/12/proposed-amendments-to-the-south-african-airways1938058.8.pdf*, accessed on 17 September 2020.para 30.3.

51 Ibid paras 26.4.3.1–26.4.3.2.3.

52 Ibid paras 26.4.4.2.1–26.4.4.2.4.

53 Ibid para 26.4.4.3.

54 2012 (2) SA 423 (WCC) ('*Southern Palace Investments*') paras 21–22.

basis and a better return for creditors instead of liquidation.[55] In addition, due to the intricacy of SAA, it is estimated that liquidation could proceed over twenty–four months without the prospect of paying dividends to general concurrent creditors, and in some instances, only paying other creditors years later.

Should the BR plan be implemented, general concurrent creditors would receive a payment within one year of the substantial implementation date.[56] Also, the fees for a liquidator as per PwC's calculation is estimated to be around R 369 million, after realising SAA's assets, which is significantly higher than the business rescue process.[57]

Naturally, a prospect is future–looking and reliant upon several variants, and there is a risk attached, making the future incapable of a precise prediction.[58] The BRPs have set out the following factors that could adversely impinge on what has been proposed in the business rescue plan: (1) in terms of the proposed restructure, the fulfilment of these conditions exceed their timelines, or the restructure fails for any reason; (2) any unexpected litigation; (3) Unforeseen damages from contracts being cancelled; (4) any amendments in legislation that may affect business rescue; (5) any barriers, refusal or changes to the business rescue plan; (6) regulatory encounters; (7) events outside the BRPs control of any nature including the impact of coronavirus (Covid–19); (8) the material inconsistencies in the information presented to the BRPs by management;[59] (9) the effect of market conditions deteriorating; and (10) PCF becoming insufficient.[60]

According to Duvenhage, SAA has the options of liquidation, foreign direct investment ('FDI'), and a recovery bundle in terms of s 16 of the PFMA. Liquidation would trigger immediate payment of 'implicit guarantees' to creditors, although the process could decrease future operational losses from continuing.[61] The reboot of SAA could attract FDI by restarting as a smaller global franchisee in collaboration with a broader global commercial airline.[62] Essentially, the government will have a minority stake, and this would require a

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55 In terms of s 150(2)(*b*)(vi) of the 2008 Act, the benefits to creditors of adopting the business rescue plan must be compared against the liquidation.

56 Op cit note 4 paras 39.3.1–39.3.2.

57 Ibid para 36.3.5.2.

58 (NGC) unreported case no 6418/2011, 18624/2011 and 66226/2011 of 16 May 2012 ('*Solar Spectrum*') para 33.

59 Op cit note 4 paras 40.1–40.1.8.

60 Ibid paras 40.1.9–40.1.10.

61 C Duvenhage 'SAA, Fly me to the moon' 01 September 2020 available at *https://www.ufs. ac.za/ templates/news-archive/campus-news/2020/september/saa-fly-me-to-the-moon?NewsItemID=941*, accessed on 15 September 2020.

62 Ibid.

change in the law to permit better FDI into SAA.[63] Lastly, a business rescue package for the airline can be sourced from the public's pension funds. In terms of s 16 of the PFMA, the purpose of the Act is:

> To regulate financial management in the national government and provincial governments; to ensure that all revenue, expenditure, assets and liabilities of those governments are managed efficiently and effectively; to provide for the responsibilities of persons entrusted with financial management in those governments, and to provide for matters connected therewith.[64]

During July of 2017, the national treasury issued a media statement from what source the government utilised the national revenue fund ('NRF') to discharge debts to Standard Chartered Bank, in order to circumvent a default.[65] It reasoned, *inter alia*, that recapitalising SAA to advance financial standing was their plan, as mentioned in the February of 2017 Budget, and that s 16 of the PFMA was used as 'the last resort' considering the problems experienced at the time.[66] Accordingly, the minister of finance may approve using the NRF to pay expenses of an 'exceptional' nature which is presently not covered for and cannot (without serious bias to the interests of public) be delayed to a prospective parliamentary distribution of funds.[67]

(d) Moratorium

Once the restructuring of the distressed company has commenced, the creditors' claims and shareholders' rights or are suspended, in order to allow the company 'breathing space'.[68] A general moratorium (or automatic stay) is a necessary consequence on legal proceedings or executions against the company, its assets, property, and the exercise of the rights of the company's creditors.[69] This is covered under s 133(1) of the 2008 Act, subject to certain exceptions.[70]

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63 Ibid.

64 See s 16 of the Public Finance Management Act 1 of 1999 ('PFMA').

65 RSA Gov 'Government transfers funds from National Revenue Fund to South African Airways' 1 July 2020 available at *https://www.gov.za/speeches/government-transfers-funds-national-revenue-fund-south-african-airways-1-jul-2017-0000*, accessed on 20 September 2020.

66 Ibid.

67 See s 16(1) of the PFMA.

68 E Levenstein *An Appraisal of the New South African Business Rescue Procedure* (published LLD thesis, University of Pretoria, 2015) 153.

69 Cassim op cit note 24 at 878.

70 See s 133(1): 'During business rescue proceedings, no legal proceeding, including enforcement action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or proceeded with in any forum, except – (a) with the written consent

Most contemporary business countries have created a rescue regime that provides 'protection' for the debtor company. The procedure is initiated by temporary bankruptcy and a belief that the company can continue as a sustainable entity. Business rescue is commonly endorsed to preserve jobs, enable the continuation of the business, ensure partial (or full) payment of its debts owed, and to safeguard investments.[71] According to Smits, the moratorium is an essential requirement for effective restructuring of a company in financial distress.[72]

During January of 2020, SA Airlink (one of SAA's feeder airlines and subsequent creditor) made an application to the high court seeking relief against SAA in terms of s 133(1)(*b*) of the 2008 Act. They further sought a declaratory order for their monetary claims against the airline not to be subjected to s 154(2) of the 2008 Act, as they are not 'debts owed' as per the provision.[73]

Lastly, they demanded R 510 million to be paid by SAA whilst under business rescue.[74] Accordingly, the court held that an order under s 133(1) of the Act must establish a *prima facie* case, coupled with reasons for the proceedings being 'necessary and appropriate'.[75] Kathree-Setiloane J dismissed the application as SA Airlink were unsuccessful in establishing a claim to 'lift the moratorium on legal proceedings against SAA'.[76]

In the *South African Airways (SOC) Limited (In Business Rescue) v National Union of Metalworkers of South Africa (NUMSA)* case,[77] the labour appeal court ('LAC') had to decide whether or not a BRP could commence with retrenchment proceedings under s 189 of the LRA, before the publication of a BR plan (as contemplated in s 150 of the 2008 Act). The court *a quo*, and this court, was tasked with balancing the rights of all stakeholders

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of the practitioner; (b) with the leave of the court and in accordance with any terms the court considers suitable; (c) as a set–off against any claim made by the company in any legal proceedings, irrespective whether those proceedings commenced before or after the business rescue proceedings began; (d) criminal proceedings against the company or any of its directors or officers; or (e) proceedings concerning any property or right over which the company exercises the powers of a trustee.'

71 Levenstein op cit note 68 at 153; see also H Rajak & J Henning 'Business Rescue for South Africa' (1999) 116 *SALJ* 262.

72 Levenstein op cit note 68 at 154; see also A Smits 'Corporate Administration: A Proposed Model' (1999) *De Jure*.

73 See s 154(2) of the 2008 Act: 'If a business rescue plan has been approved and implemented in accordance with this Chapter, a creditor is not entitled to enforce any debt owed by the company immediately before the beginning of the business rescue process, except to the extent provided for in the business rescue plan.'

74 *SA Airlink (Pty) Ltd v South African Airways (SOC) Limited (In Business Rescue)* reported case no 2020/01078 of 2 March 2020 available at *https://www.saripa.co.za/downloads/20200302-SA-Airlink-v-SAA.pdf* , accessed on 20 September 2020.

75 Ibid.

76 Ibid paras 64–66.

77 2020 (41) ILJ 2113 (LAC) ('*SAA NUMSA* LAC').

(employees included) in the BR plan, considering the interpretation of s 136 of the 2008 Act.[78]

The BRPs issued notices in terms of s 189 or s 189A of the LRA process, in an effort to rescue the airline. However, the respondents had demanded it be withdrawn or postponed until the BR plan is adopted.[79] The court *a quo* upheld this view. It was argued that this judgment could be instrumental in future business rescue plans failing.[80] Hence, on appeal, the main issue was interpreting s 136(1)(*b*) of the 2008 Act.[81] The court found that the main objective of a business rescue is to provide for the efficient rescue and recovery of a financially distressed company whilst balancing the rights and interests of all relevant stakeholders (including employees) and consequently supported the labour court's judgement.[82] Secondly, although the court attempted to encourage job preservation, this judgment could influence employers under business rescue to consider retrenchments going forward. The initiation of a consultation process was previously prescribed when an employer anticipated retrenchment. Following to this judgement and throughout the business rescue proceedings, 'the need to retrench must be rooted in the business rescue plan'.[83]

With regard to the issue on 'voluntary severance packages', the court held that BRPs could make an offer unilaterally to avoid retrenchments before the rescue plan is adopted. Ultimately, both courts have set a precedent by creating a moratorium on retrenchments during the start of the rescue plan and prior to its publication.

In short, the verdict states that the voluntary severance packages must be contemplated before the retrenchment process, in order to balance the dispute between advancing fair labour practices and the duty of BRPs to balance the rights of all affected parties. [84]

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78 Ibid para 1.

79 Ibid para 2.

80 T Jordaan, A Bezuidenhout & J Osmond 'A Balancing Act: The labour appeal court gives final verdict on *SAA (in business rescue) v NUMSA* employee retrenchment appeal' 10 July 2020 available at *https://www.cliffedekkerhofmeyr.com/export/sites/cdh/en/news/publications/2020/dispute/Downloads/Business-Rescue-Restructuring-Insolvency-and-Employment-Alert-10-July-2020.pdf*, accessed on 22 July 2020. See also W Badenhorst, S Horsfield & R Chasela 'COVID–19 – *NUMSA v SAA* – The death knell to successful business rescue?' available at *https://www.lexology.com/library/detail.aspx?g=03c5c21b-096a-401e-9d83-5be2db71c2e3,* accessed on 22 July 2020.

81 See s 136(1): 'Despite any provision of an agreement to the contrary – (b) any retrenchment of any such employees contemplated in the company's business rescue plan is subject to [s] 189 and 189A of the [LRA] 66 of 1995, and other applicable employment related legislation.'

82 *SAA NUMSA* LAC supra note 77 paras 11–12.

83 Ibid para 11.

84 Ibid paras 41–44.

(e) Post–commencement finance

The nature and extent of PCF is outlined in s 135 of the 2008 Act and is fundamental to the business rescue proceedings, like the moratorium.[85] The courts have drawn parallels between the ability to secure PCF and the requirement of a reasonable prospect being met.[86] Accordingly, by trial–and–error, BRPs have suggested that 'no PCF means no reasonable prospect for rescue unless proven otherwise.'[87] After business rescue commences, it is imperative to gather funding that will allow the company to continue as a 'going concern' and enable business activities such as: labour expenses; rent; insurance; maintenance of contracts; assets; and other operational costs.[88]

Many business rescue failures are related to the inability to facilitate PCF. Naturally, in order to raise funds, the distressed company would look to existing creditors to either compromise or postpone their right to claim or to extend financial support to them. However, access to finance becomes inaccessible during economic stagnation (in hindsight, the 2008 global financial crisis and the current Covid–19 pandemic).[89]

Some reasons for the lack of financing may be due to institutions trying to avoid risks and only extending loan financing upon assets as surety (and the financially distressed are seldom in the positions to satisfy this condition). Private equity, sale, leaseback agreements, and business rescue funds are approached as a last resort to invest in the company.

However, some drawbacks could be that they are either not well–developed in South Africa or are reluctant to invest in an ailing company.[90] Additionally, the law in this space is underdeveloped. Judicial management did not deal with the present biases concerning insolvency law with regard to an 'undue preference' given to creditors' claims.[91] Although

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85 Cassim op cit note 24 at 882.

86 J Calitz & G Freebody 'Is post–commencement finance proving to be the thorn in the side of business rescue proceedings under the 2008 Companies Act?' (2016) *De Jure* 267. See also *A G Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd* 2012 (5) SA 515 (GSJ) ('*A G Petzetakis*') para 29; *Southern Palace Investments* supra note 54; *Oakdene Square* SCA supra note 64 para 33; *Newcity Group (Pty) Ltd v Pellow, China Construction Bank Corporation Johannesburg Branch v Crystal Lagoon Investments 53 (Pty) Ltd* (2013) ZAGPJHC 54.

87 M Pretorius 'Business Rescue: Status Quo report: Final Report' *Business Enterprises – University of Pretoria* 2015 available at *https://static.pmg.org.za/151110Business_Rescue.pdf* 46, accessed on 16 September 2020.

88 M Pretorius & W Rosslyn-Smith 'Expectations of a business rescue plan: International directives for Chapter 6 implementation' (2014) *Southern African Business Review* 132.

89 W Du Preez 'Post–commencement finance: The silver bullet for business rescue?' *Business Rescue Exchange* available at *https://www.brexchange.co.za/pcm-silver-bullet/*, accessed on 22 September 2020.

90 Ibid.

91 Calitz & Freebody op cit note 86 at 286.

business rescue is regarded as more 'debtor–friendly' and represents a complete paradigm shift from its precursor, the benefits will take time to unfold.[92]

Furthermore, investors may be unwilling to extend finance due to the nature of the ranking of creditors.[93] The order of ranking PCF (as it is presently understood in the Act and in practice) is as follows:

(1) The practitioner's remuneration and costs or disbursements are paid first in terms of s 135(3), including all other costs from business rescue proceedings as a top priority.

(2) All employees who have worked since the commencement of business rescue (in terms of ss 134–135 of the 2008 Act) are considered 'super–priority' post–commencement financiers. (This provision is unique to South Africa)

(3) Secured lenders or creditors who had security in place before business rescue or secured post–commencement financiers in the order it was granted. (It is unclear about whether secured creditors will rank before PCF lenders)

(4) Insolvency creditors.

(5) Unsecured PCF lenders claim, in the order, they were incurred.

(6) All other unsecured creditors (includes employees' salary before business rescue).[94]

Consequently, the preference in ranking would remain the same should a BR proceeding be converted into liquidation of the company, however, the claims in this instance would rank below the costs of liquidation.[95]

At the time of this research, SAA needs around R 10.5 billion to resume operation.[96] Various sources for funding have been considered, and institutions and lenders have been approached for the financing. It is possible that the NRF could be utilised in order to attract a prospective equity partner, despite the government's assurance not to invoke s 16.[97] On 28 October 2020, the 'Medium–Term Budget Policy Statement 2020' ('MTBPS') detailed the

92 Ibid.
93 Ibid at 271.
94 Du Preez op cit note 89.
95 Calitz & Freebody op cit note 86 at 271; s 135(4) of the 2008 Act.
96 'Gordhan: SA government will provide initial funding for SAA' *Fin24* 19 September 2020 available at *https://www.news24.com/fin24/companies/industrial/sa-government-to-help-fund-national-airlines-rescue-20200919,* accessed on 22 September 2020.
97 Duvenhage op cit note 61.

allocation of R 10.5 billion to implement the restructuring of SAA. A further R 6.5 billion was extended to the airline, in order to discharge its guaranteed debt and interest.[98]

(f) Conclusion

In tandem with the above conditions, the BR plan would be fully operational once the rescue plan is approved and executed in terms of s 152 of the Companies Act. Transactions in terms of s 54(2) of the PFMA read with the 'Significance and Materiality Framework for SAA' are approved by the minister of public enterprises and the minister of finance (as executive authority for SAA). [99]

Transactions that are subject to approval in terms of the memorandum of incorporation ('MoI') must be assented to by the minister of public enterprises, in his capacity as a representative shareholder of SAA.[100] Agreements between employees and trade unions regarding the workforce reduction and new terms and conditions under current market conditions must be reached within the stipulated period.[101] Furthermore, a confirmation evidenced by letter, of the government's assistance to provide funding for the rescue plan from the DPE and the Department of National Treasury at a specified date.[102] On 12 August 2020, the DPE confirmed that the conditions were met and were in the process of managing four stages to complete the rescue plan. They are as follow:

> 'The restructuring of the airline – including the implementation of Voluntary Severance Packages to employees; the appointment of non–executive directors and new management team; the selection and appointment of Transaction Advisors; and the formation of a customer–centric airline designed to be lean, technology capable, digitally modernised and agile to service all market segments.'[103]

In summary, SAA was able to satisfy the court that they were financially distressed, hence the commencement of this BR plan and the requirement of a reasonable prospect which is reliant on the PCF being timeously available as pledged by its lenders.

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98 National Treasury RSA 'Medium Term Budget Policy Statement 2020' 28 October 2020 para 39, available at *http://www.treasury.gov.za/documents/mtbps/2020/mtbps/FullMTBPS.pdf*, accessed on 14 November 2020.

99 Ibid.

100 Ibid paras 2020 paras 42.1–42.1.3

101 Ibid para 42.1.4; See also 'Business Rescue of South African Airways (SOC) Limited' 13 July 2020 para 33, available at *https://matusonassociates.co.za/wp-content/uploads/2019/12/proposed-amendments-to-the-south-african-airways1938058.8.pdf*, accessed on 17 September 2020.

102 Ibid para 42.1.5; see also: para 28.

103 RSA Gov 'Public Enterprise on implementing SAA Business Rescue Plan' 12 August 2020 available at *https://www.gov.za/speeches/public-enterprise-implementing-saa-business-rescue-plan-12-aug-2020-0000*, accessed on 15 September 2020.

CHAPTER 4

I INTRODUCTION

With regard to whether the requirements have resulted in the successful implementation of the process, it is noted that with business rescue, we tend to consider the failures rather than the successes. The CIPC provides an overview of the statistics regarding business rescue proceedings. The CIPC regulates business rescue and is governed by s 185(1) of the 2008 Act.[1]

In terms of a report by the CIPC on the status of business rescue proceedings as at 31 October 2020, out of the 3818 cases for which business rescue proceedings were commenced (from May 2011 to October 2020), 675 proceedings were substantially implemented by way of filing a 'notice of substantial implementation of business rescue plan' (in terms of s 152(8) of the 2008 Act).[2] Despite the low rate of success at present (17 per cent), the process is an improvement from its precursor (judicial management).

One of the most significant differences is the administration of the procedure. With the former, an applicant would need to receive a provisional and final order in order to enable the process.[3] Business rescue offers two gateways to enter the process, and there is no need to approach the court twice. This is indicative of a more accessible, time–saving, and cost–effective mechanism that seeks to save companies at an early stage, instead of when it is too late.[4]

The objective of this chapter is to provide recommendations for the shortcomings of business rescue. It mainly discusses recommendations for the two main recovery requirements to begin the process (financial distress and a reasonable prospect) as well as the implications of PCF and a moratorium, *inter alia*.

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1 'The Companies and Intellectual Property Commission (CIPC) manual in terms of s 14 of the Promotion of Access to Information Act 2 of 2000' available at *http://www.cipc.co.za/files/5215/6620/2870/Promotion_of_Access_to_Information.pdf#:~:text=CIPC%20was%20established%20as%20a,Companies%20Act%2C%2071%20of%202008*, accessed on 22 July 2020.

2 CIPC 'Status of business rescue proceedings in South Africa October 2020' available at *http://www.cipc.co.za/files/3616/0490/5024/Status_of_Business_Rescue_Proceedings_in_South_Africa_-_as_at_31_October_2020_v1.0.pdf*, accessed on 15 November 2020; s 152(8) of the 2008 Act states that, 'when the business rescue plan has been substantially implemented, the practitioner must file a notice of the substantial implementation of the business rescue plan.'

3 P Kloppers 'Judicial Management – A corporate rescue mechanism in need of reform?' (1999) 10 *Stell LR* 362–363.

4 As opposed to judicial management that required a distressed company to be already insolvent.

II CONCLUSION AND RECOMMENDATIONS

(a) Financial Distress

In *Merchant West Working Capital Solutions (Pty) Ltd*[5] the court found that a company that was already insolvent should be liquidated relative to a rescue process.[6] However, the court in *Tyre Corporation Cape Town (Pty) Ltd*[7] held that when determining this requirement, it should not be viewed as automatically excluding companies that are already insolvent or are experiencing illiquidity from bringing a business rescue application.[8]

Essentially, the former interpretation would go against the purpose of the process to ensure an efficient rescue that balances the rights and interests of all stakeholders (s 7(d) of the 2008 Act).[9] Automatically excluding insolvent companies would accelerate job losses and immediate debt repayment, instead of allowing them the opportunity to prove a reasonable prospect of their (restructured) business activities, securing better returns than an imminent liquidation (as an alternative objective).[10]

In terms of s 129(3)(*a*) of the 2008 Act, after a resolution is instituted, a notification must be distributed from its effective date to its stakeholders (together with a notice attesting the credibility of the grounds on which the resolution was founded). Senior BRPs have recommended a 'pre–assessment' prior to the commencement of business rescue, as to avoid personal liability on boards.

First, the pre–assessment could assist with determining whether a company is financially distressed and whether there is a reasonable prospect of success (a commercially viable company).[11] Secondly, before the actual administration of business rescue, a company has an objective preview of the plan.[12] Thirdly, this evaluation will decrease the number of

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5 (2013) ZAGPJHC 109 ('*Merchant West*').

6 Ibid para 8.

7 2017 (3) SA 74 (WCC) ('*Tyre Corporation*').

8 Ibid paras 15–16.

9 M F Cassim, 'South African Airways makes an emergency landing into business rescue: Some burning issues' (2020) *SALJ* 203–204; *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd* (ZAGPJHC) unreported case no 13/12406 of 10 May 2013 ('*Merchant West*') para 8; *Redpath Mining SA (Pty) Ltd v Marsden* (2013) ZAGPJHC 148 para 47; *Tyre Corporation* supra note 7 para 15.

10 Ibid at 204.

11 'Business Rescue Pre–Assessment' available at *https://matusonassociates.co.za/services/assessments/business-rescue-pre-assessment/*, accessed on 02 November 2020; E Levenstein 'Business rescue in South Africa: shortcomings, suggestions and possible amendments to Chapter 6 of the 2008 Companies Act' (2018) *CR* 10.

12 'Business Rescue Pre–Assessment' available at https://matusonassociates.co.za/services/assessments/business-rescue-pre-assessment/, accessed on 02 November 2020

entities put into business rescue, in that way, expanding the likelihood of success.[13] Fourthly, it will decrease the number of business rescues being converted into liquidation. Finally, it will cut the excessive costs linked with failed business rescues.[14]

Furthermore, the following recommendations, from a finance perspective, could assist the courts and BRPs in their determination. Du Toit, Pretorius, and Smith submit, *inter alia*, the 'financial ratios analysis' and general 'cash–flow ratios' approach as tools to determine whether a company is financially distressed.[15] As mentioned in *Welman v Marcelle Props,*[16] 'distressed relates to an ailing company and not the terminally nor the chronically ill.'[17] A financial–ratios analysis can be a variant used in determining the ratio between a financially sound company and an ailing company.[18]

Accordingly, the investigation would need to be compared to companies operating in the specific industry as the distressed company. Essentially, the comparison is made upon the yardstick of that industry, size of the enterprise, and the present market conditions.[19] The analysis of ratios is reliant on the data collected (financial statistics) being reliable, succeeding viability tests, and possibly due diligence.[20]

The 'cash–flow ratio' approach is a tool used to calculate and confirm that the company is financially distressed.[21] The tool is useful when certain pre–conditions are satisfied. The first step would be to compare the 'norms' of the industry the company operates in against the median over three years or at least that average.[22] Subsequently, the financial reports used to calculate the norms must be of a similar commercial environment.

For example, a comparison of a company in a third–world country against a developed country would be idle, as well as the comparison of companies operating in disparate sectors.[23] Finally, a larger company cannot be compared to a smaller business.

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13 Ibid.

14 Ibid.

15 A C Du Toit, M Pretorius, & W Rosslyn-Smith 'Small, medium and micro enterprises' distress and factual evaluation of rescue feasibility' (2019) 11(1) *Southern African Journal of Entrepreneurship and Small Business Management* at 6–7, available at *https://doi.org/10.4102/sajesbm.v11i1.149*, accessed on 17 October 2020.

16 (2012) ZAGPJHC 32 ('*Welman*').

17 Ibid para 2.

18 Du Toit, Pretorius & Rosslyn-Smith op cit note 15 at 7.

19 Ibid.

20 Ibid.

21 Ibid at 8.

22 Ibid.

23 Ibid. See also L Jooste 'Cash flow as a yardstick for evaluating financial performance in African businesses' (2006) 32(7) *Journal of Managerial Finance* 569–579, available at *https://doi.org/10.1108/03074350610671566*, accessed on 17 October 2020.

Furthermore, the cash–flow statements will show and affirm the company is in financial distress and not directly a reasonable prospect (of rescue).[24]

(b) Reasonable prospect

As discussed in Chapter 2 of this dissertation, this requirement is subject to interpretational problems as there is no specific threshold mentioned in the 2008 Act. In *Propspec Investments (Pty) Ltd*[25] it is noted that although the term is not defined, it does not relate to a 'reasonable possibility'.[26] It is substantiated on reasonable grounds and not 'speculative suggestions' or 'vague averments'. Evident from the SCA in *Oakdene Square Properties*,[27] the test is often a subjective examination based on the personal opinion of a BRP, or the respondents, on whether the company should be rescued or liquidated.[28]

Accordingly, it lacks the formal context of objective facts that can be used to support it from a business viewpoint.[29] Consequently, when determining a reasonable prospect, an objective or subjective test must not be applied rigidly, and the feasible approach would be a subjective test on the firm and proven objective business facts.[30] The assessment of this requirement must be viewed through the lens of a 'reasonable businessman'. The query would then be

> 'whether a reasonable, experienced businessman in that particular field would conclude that there is a reasonable prospect of success given the objective proved and not disputed facts.'[31]

Southern Palace Investments,[32] *Koen*,[33] *Zoneska Investments (Pty) Ltd*,[34] *Propspec Investments (Pty) Ltd*,[35] and *Oakdene Square Properties*[36] point out that the essential requirement to satisfy a reasonable prospect (of rescue) would be to provide information that is 'factual, objective, ascertainable and concrete.'

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24 Du Toit, Pretorius & Rosslyn-Smith op cit note 15 at 8.
25 2013 (1) SA 542 (FB) ('*Propspec Investments*').
26 Ibid para 12.
27 2013 (4) SA 539 (SCA) ('*Oakdene Square* SCA').
28 Ibid.
29 Du Toit, Pretorius & Rosslyn-Smith op cit note 15 at 4.
30 K Braatvedt 'Is the test for reasonable prospect objective or subjective?' available at *https://www.tma-sa.com/info-centre/item/223-is-the-test-for-reasonable-prospect-objective-or-subjective.html*, accessed on 10 June 2020.
31 Ibid.
32 2012 (2) SA 423 (WCC) ('*Southern Palace Investments*').
33 *Koen v Wedgewood Village Golf & Country Estate (Pty) Ltd* 2013 (1) SA 191 (WCC) ('*Koen*').
34 *t/a Bonatla Properties (Pty) Ltd v Midnight Storm Investments 386 Ltd* 2012 (4) All SA 590 (WCC) ('*Zoneska*').
35 *Propspec Investments* supra note 25.
36 *Oakdene Square* SCA supra note 27.

In addition to the submissions made in Chapter 2, the following recommendations could be of secondary assistance in determining the threshold of a reasonable prospect. Du Toit, Pretorius, and Smith submit that the following methods to ascertain the requirement in light of small, medium and micro–enterprises ('SMMEs') under constricted timelines.[37]

From a business management viewpoint, the determination of a profit–making company must be established by a BRP assessing whether all the aspects required of a profitable enterprise is present after the proceedings have been terminated.[38] These aspects can be defined by basic business management and entrepreneurial principles. The essential aspects must be proved at the start of the process, whereas some can be introduced later in the proceedings. [39]

The first method is an 'opportunity analysis' ('OA'). An OA aims to gather 'whether an opportunity exists for doing meaningful business.' This method was initiated when researching prospects for new businesses and the sale and purchase of existing companies.[40] Du Toit, Pretorius, and Smith consider this as a tool to establish a reasonable prospect for companies in financial distress, and that start–ups and rescue situations are similar and could thus contribute to understanding the disputed requirement.[41]

With an OA, the components of a company are divided into five core business model groups, namely: (1) demand for concept offering (value propositions); (2) team; (3) resources; (4) competitive environment (profitability); and (5) finance.[42]

The analytical approach for a company in financial distress could use the same principles and identify the problem areas. The OA uses a feasibility perspective to establish a reasonable prospect. Hence, it looks at whether the essential requirements are satisfied at the precise time for the restructured company.[43]

The second method is the 'do we have a business?' test ('DWaB test'), which has developed on the details of the feasibility principles and the OA. Essentially, five questions signify the features required for the company to exist and would be answered by a 'reasonable and experienced businessperson'.[44] Despite an attempt by Eloff AJ in *Southern*

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37 Du Toit, Pretorius & Rosslyn-Smith op cit note 15 at 2
38 Ibid at 6.
39 Ibid.
40 Ibid, see also J A Timmons & S Spinelli *New venture creation: Entrepreneurship for the 21st century* 6 ed (2003).
41 Du Toit, Pretorius & Rosslyn-Smith op cit note 15 at 6.
42 Ibid.
43 Ibid.
44 Ibid.

Palace Investments 265 (Pty) Ltd[45] to guide the concept with a checklist that arguably 'set the bar too high', the following questions encompassed in this test are more broad and objective in nature.[46] They are:

> '(1) Whether there is demand for the product and/or service. This refers directly to the concept offering and the significance of the demand for this. This demand can be defined as the utility of goods or service from an economic agent.
>
> (2) Does the capacity exist to deliver on the demand? Capacity can also be described as the output capability over a specific period, infrastructure and the human resource capacity.
>
> (3) Is there a profitable business case in motion? This question refers to the reasoning behind initiating the business or project and whether there is economic logic supporting the business model.
>
> (4) Are the cash–flow projections positive? This can be described as the amount of liquidity moving through the business and/or the ability of the business to pay immediate creditors.
>
> (5) Are there potential flaws (caveats) in the business model that may render the other factors useless?
>
> These caveats can be any constraints to the optimal functioning of the business. These questions are progressive in that a negative answer to one can have an eliminating power.'[47]

The OA and the DWaB test are objective (factual) methods that focus on the feasibility requirement, which must subsequently be examined through due diligence and validity testing.[48]

(c) Moratorium

As discussed in Chapter 3, once the main requirements to commence business rescue are satisfied, one main legal consequence is a general moratorium, or a stay on debts and liabilities, that may be claimed from the distressed company. During this interval, a BRP is planning a business rescue plan to enable the success of the rescue process. The moratorium is of 'cardinal' importance in the whole process.[49]

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45 *Southern Palace Investments* supra note 32.
46 Ibid para 28.
47 Du Toit, Pretorius & Rosslyn-Smith op cit note 15 at 6.
48 Ibid, see also L F Gillman *Due diligence: A financial and strategic approach* (2001).
49 F H I Cassim (ed), M F Cassim, R Cassim et al *Contemporary Company Law* 2 ed (2012) 879.

Initially, before an application is made to commence business rescue, there is a statutory obligation on the board to send a notification to all stakeholders once the distressed company has established that they are financially distressed in terms of s 129(7) of the 2008 Act. In the event of the company not pursuing the resolution after they have reasonable grounds to do so, they must provide notification to affected persons on their reasons, and this provides the stakeholders with an opportunity to make a court application.[50]

However, in the absence of a moratorium, this obligation can be detrimental as it could lead to creditors demanding payments, suppliers cancelling business, labour actions instituted by employees together with trade unions, and this is likely to result in a possible and immediate liquidation.[51]

In addition to the negative domino effect, when a distressed company continues to do business (i.e. continues trading) and fails to abide by the above provision, they are accountable for the losses sustained.[52] For example, when a shareholder, unaware of its status, continues to do business with the financially distressed company and is later left with no security,[53] the board may be regarded as 'reckless' and charged with gross negligence.[54]

However, a company is protected under a civil claim in terms of s 22(1) and s 218(2) if they were diligent in understanding whether or not the company is financially distressed and, on this knowledge, optioned not to send the notification in good faith.[55]

Section 77(9) of the 2008 Act (the business judgement rule or 'BJR') acts as a safeguard against personal liability of directors where their decisions were reasonable and sincere.[56] In essence, the BJR is to permit the complete exercise of duties by directors, exclusive of such exposure.[57] Likewise, a possible reason why directors of a distressed company opt to continue trading and are reluctant to file for business rescue is because of the predicament the boards face when battling to weigh–up the risk of trading recklessly to the

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50 Section 129(7) of the Companies Act 71 of 2008.

51 A Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (unpublished PhD thesis, University of South Africa, 2010) 66.

52 Section 218(2) of the 2008 Act.

53 D Kotzé 'Catch 22 Directors' duties under s 129(7) of the Companies Act (2013) *De Rebus* 42—43 available at *http://www.saflii.org/za/journals/DEREBUS/2013/84.html*, accessed on 12 August 2020.

54 Section 22(1) of the 2008 Act.

55 E Levenstein *An Appraisal of the New South African Business Rescue Procedure* (published LLD thesis, University of Pretoria, 2015) 322.

56 K Weyers & J Osmond 'Beyond the balance sheet: Considering directors' liability in financially distressed times' 7 April 2020 available at *https://www.cliffedekkerhofmeyr.com/en/news/publications/2020/dispute/business-rescue-newsletter-7-april-Beyond-the-balance-sheet-considering-directors-liability-in-financially-distressed-times.html*, accessed on 4 November 2020.

57 Ibid.

risk of giving up their powers to a BRP which may not factually be in the best interests on the company.

Essentially, a BRP does not have an accurate idea on the operations and monetary dealings of the ailing company. Hence, he or she would not be able to fully participate in understanding all the particulars of the business. To remove the current BOD when the company needs them the most could be inimical. Hence, the solution would be to allow the board to work alongside the BRP to achieve a successful restructure.[58]

(d) Post–commencement finance

In *National Labor Relations Board v Bildisco & Bildisco*,[59] the court commented that an important objective of restructuring is to avoid the liquidation of the debtor–company due to consequent loss of jobs and the likely exploitation of monetary funds. A successful restructure may only occur in some cases where new creditors fuel the distressed company with further funds.[60]

As discussed in Chapter 3, the courts have drawn parallels between the ability to secure post–commencement financing (PCF) and the requirement of a reasonable prospect being met. Accordingly, an unwritten rule by BRPs suggests that 'no PCF means no reasonable prospect for rescue unless proven otherwise.'[61] In *A G Petzetakis International Holdings Ltd*[62] the court denied the rescue application on the basis that there were no reasonable prospect of success and no evidence (from its founding papers) that the process would result in better returns for creditors than liquidation. The rescue was dependent on a substantial amount of financial injection (PCF), which was not signalled in its papers of how it would be forthcoming.[63]

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58 E Levenstein 'Opportunities for investors arising from the South African business rescue process' 6 May 2020 available at *https://www.werksmans.com/legal-updates-and-opinions/opportunities-for-investors-arising-from-the-south-african-business-rescue-process/*, accessed on 15 May 2020. See also C Els, M Yudaken, L Kahn et al 'Webinar: Sustaining businesses in challenging times' 10 June 2020 available at *https://www.webberwentzel.com/News/Pages/webinar-sustaining-businesses-in-challenging-times.aspx*, accessed on 20 June 2020.

59 US 513 (1984) 528 ('*Bildisco*').

60 Cassim op cit note 49 at 882.

61 M Pretorius 'Business Rescue: Status Quo report: Final Report' *Business Enterprises – University of Pretoria* 2015 available at *https://static.pmg.org.za/151110Business_Rescue.pdf* 46, accessed on 16 September 2020.

62 *v Petzetakis Africa (Pty) Ltd* 2012 (5) SA 515 (GSJ) ('*A G Petzetakis*').

63 Ibid para 19.

The lack of agility of companies to acquire PCF is one explanation for business rescue applications failing.[64] The challenge to raise financing through loans could be barred as these institutions require unencumbered assets (such as surety) and would be more cautious in extending finance to distressed companies.[65]

Section 135 of Chapter 6 of the 2008 Act provides for PCF, which ranks in preference to existing unsecured claims against the distressed company. This is an incentive to raise finance and encourage creditors to extend funding in exchange for 'super–priority status'.[66] *Merchant West Working Capital Solutions (Pty) Ltd*[67] confirmed the order of preference in the process, and it is evident that the secured and post–commencement financiers would rank before the secured lenders prior the start of a rescue plan.[68]

Accordingly, while under business rescue, a company must be able to discharge its present operational and financial obligations to exist, or else it would subsequently be liquidated. This also applies when an investor is acquiring the company.[69]

As discussed in Chapter 3, PCF can be extended by banks or the companies' shareholders (existing lenders). In addition, a potential investor could proffer PCF during an acquisition process. Essentially, this is a strategic option under the Companies Act. Under business rescue, financially distressed companies are desirable to international and domestic investors as the company, or its core assets, can be purchased at a bargain through an acquisition.[70]

The business rescue plan will include the final acquisition proposal after it is voted on by creditors and shareholders (if affected). The proposed restructure could either vary from the sale of assets or shares to the company being sold.[71] An example of a company that has been successfully restructured through an acquisition of its business (under business rescue)

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64 W Du Preez 'Post–commencement finance: The silver bullet for business rescue?' *Business Rescue Exchange* available at *https://www.brexchange.co.za/pcm-silver-bullet/*, accessed on 22 September 2020.

65 Ibid.

66 Cassim op cit note 49 at 884; s 135(2) of the 2008 Act.

67 *Merchant West* supra note 9 para 21.

68 Ibid.

69 Levenstein op cit note 58.

70 E Levenstein 'Opportunities for Chinese investors arising from the new business rescue provisions of the South African Companies Act 2008' available at *https://www.werksmans.com/legal-updates-and-opinions/opportunities-for-chinese-investors-arising-from-the-new-business-rescue-provisions-of-the-south-african-companies-act-2008/*, accessed on 16 October 2020.

71 Ibid.

is Pearl Valley Golf Estate.[72] During 2011 and due to declining market conditions in the golf estate industry, the distressed company was acquired by Standard Bank in 2013.[73]

In 2015, Pearl Valley was placed first in the residential estate category in South Africa by New World Wealth after effective management and improvements made by the bank.[74] Other successful companies that were under business rescue and thereafter acquired by third–parties for successful restructure include:

> 'Southgold Mine (acquired by Witsgold), Top TV (acquired by a Chinese company Star Sat), Meltz Success (acquired by the Hub), Advanced Technologies & Engineering (Aeronautical) Engineering (acquired by Paramount), Moyo Restaurants (acquired by Fournews), Optimum Coal Mine (acquired by Tegeta) and SA Calcium Carbide (management buy–out).'[75]

Likewise, PCF is critical for the continuation of business operations, which preserves the value of the company. Without it, there would be nothing left to acquire.[76]

III CONCLUSION

A pandemic like Covid–19 has blindsided many companies and regrettably accelerated defaults that resulted in more companies in South Africa experiencing financial difficulty. Chapter 3 focused on the current case discussion of SAA under voluntary business rescue. Despite the airline suffering financial setbacks before the pandemic, the aviation industry was adversely affected due to the national– and international travel bans under lockdown.

A BR plan for SAA was released on 16 June 2020 subject to amendments. It is implicitly anticipated in the Companies Act of 2008 that a business rescue process should end within ninety days, subject to the extension of time granted by the court.[77] Should the proceedings extend over three months, the BRPs must prepare progress reports coupled with an update of each subsequent month until the rescue plan had ended.[78]

Reflecting on the delays and the extension of certain aspects of the business rescue process for a large airline like SAA, it is recommended that this period be extended to seven

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72 'Mantis and Val de vie acquire Pearl Valley Golf and Country Estate' *Business Events Africa* 4 December 2015 available at *https://www.businesseventsafrica.com/2015/12/04/mantis-and-val-de-vie-acquire-pearl-valley-golf-and-country-estate/*, accessed on 02 November 2020.

73 Ibid.

74 Ibid.

75 Levenstein op cit note 58.

76 Ibid.

77 Cassim op cit note 49 at 877.

78 Ibid.

months (for larger corporations) and five months for medium–sized businesses.[79] Likewise, the business rescue process for SAA commenced on 5 December 2019 and is still ongoing.

At present, numerous private equity partners have come forward to invest in the airline, on the condition that they would be absolved from paying the airline debts and restructuring expenses.[80] The progression of this transaction is anticipated to be either during December 2020 or the first quarter of 2021.[81] According to Fadugba, 'there is inherent value in an existing airline which cannot be easily replicated in a new replacement carrier' and consequently a reason to keep SAA in existence through the option of investments from a private equity partner.[82]

Moreover, the requirements to commence the rescue process for public companies are the same as private companies, however, the courts must apply a higher threshold in determining if there is a viable business before allowing a business rescue proceeding to commence. If the company is not commercially feasible, it would be burdening to the fiscus to place the ailing public company into business rescue.

Accordingly, a distressed company should only consider business rescue once they have decided on a plan to exit the process. The plan could entail recapitalisation or the order to discharge its debts. 'Business rescue offers a framework, not a solution.' [83] Also, the legal moratorium, the temporary suspension, or cancellation of contracts by a BRP, and the requirement of post–commencement financing will not inevitably remedy the reasons a company is in distress. It simply offers a framework and a period for the company to find solutions to recover.[84]

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79 Levenstein op cit note 55 at 626.

80 'Gordhan: Private equity partners will not take on SAA's debt or restructuring costs' *News24Wire* 12 November 2020 available at *https://www.engineeringnews.co.za/article/gordhan-private-equity-partners-will-not-take-on-saas-debt-or-restructuring-costs-2020-11-12/rep_id:4136*, accessed on 14 November 2020.

81 Ibid.

82 P Shaw-Smith 'South African Airways' Fate Tied to International Partner' *Ain Online* 26 October 2020 available at *https://www.ainonline.com/aviation-news/air-transport/2020-10-26/south-african-airways-fate-tied-international-partner*, accessed on 14 October 2020.

83 J Jones & M Mahlangu 'Business Rescue offers a framework, not a solution' 02 June 2020 available at *https://www.webberwentzel.com/News/Pages/business-rescue-offers-a-framework-not-a-solution.aspx*, accessed on 12 October 2020.

84 Ibid.

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Section 5(1)

Section 7(d)

Section 7(k)

Section 128(1)(*b*)(iii)

Section 128(1)(*f*)(i–ii)

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Section 129(3)(*b*)

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Section 131(4)(*a*)(i–iii)

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Section 134

Section 135(1)
Section 135(3)
Section 135(4)
Section 136(1)(*b*)
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