A CRITICAL ANALYSIS OF THE REQUIREMENTS NEEDED FOR THE COMMENCEMENT OF BUSINESS RESCUE IN SOUTH AFRICA

BY

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DEDICATION

I dedicate this work to the pillars of my journey, the guiding lights who have shaped my academic pursuit and personal growth. First and foremost, I express my deepest gratitude to my Master, Jesus Christ, whose unwavering presence has been my source of strength and inspiration throughout this educational endeavour.

To my beloved parents, whose boundless love and sacrifices have paved the way for my educational journey, I owe a debt of gratitude that words cannot fully capture. Your constant encouragement and support have been my foundation.

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ABSTRACT

The ripple effects of COVID 19, the rise of inflation, interest rate hikes, and the negative effects of the Russia-Ukraine war are some of the reasons that have led to the poor performance of global economies.[1] South Africa is no exception to the negative impacts of these global challenges. South Africa, which is still a young democracy, faces unique challenges such as load-shedding. Load-shedding has adversely impacted all businesses that are being forced to operate at a loss because of the additional costs they are incurring to procure alternative electricity sources to keep their businesses operational.[2] Interest rate hikes have also impacted South African businesses to the extent that they have been described as a 'punch to the gut for businesses already struggling.'[3] These challenges bear negative consequences on the South African economy at large because both small and big businesses may be forced to default on their payment obligations due to insolvency. Insolvency usually results in businesses being placed in liquidation, which may result in their ultimate closure and job losses. To avoid this, South Africa, like other countries, has adopted a corporate rescue process as an alternative to liquidation proceedings. This corporate rescue process is commonly referred to as 'business rescue', and it is necessary to analyse its requirements to ensure that the maximum potential of this process is realized and that companies benefit more from it.

[1] Justin-Damien Guenette, Philip Kenworthy & Collete Wheeler 'Implications of the War in Ukraine for the Global Economy' (2022) *World Bank Group* 4.
[2]Gareth Cremen 'Businesses are under pressure to survive the South African economy strained by continuous blackout' available at *https://www.engineeringnews.co.za/article/businesses-are-under-pressure-to-survive-the-south-african-economy-strained-by-continuous-blackouts-2023-05-30* accessed on the 7th of June 2023.
[3] Ibid.

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ABBREVIATIONS

1926 Act	Companies Act 46 of 1926
1973 Act	Companies Act 61 of 1973
2008 Companies Act	Companies Act 71 of 2008
BRP	Business Rescue Practitioner
Constitution	Constitution of the Republic of South Africa of 1996
Covid-19	Coronavirus Disease
DTI	Department of Trade and Industry
MoI	Memorandum of Incorporation
CIPC	Companies and Intellectual Property Commission

CHAPTER ONE

INTRODUCING THE CONCEPT OF BUSINESS RESCUE

I) INTRODUCTION

South Africa is experiencing turbulent economic times. It is important to acknowledge the effect of the economic crisis on private companies and on the general public.[4] These economic challenges are impediments to the growth of the South African economy which demands the creation of employment opportunities, higher incomes, improved standards of living, enhanced tax revenues, lower poverty rates, and more investment opportunities. Therefore, it is essential to safeguard the growth of the South African economy by establishing processes or mechanisms to rescue companies in financial distress. This is important because failure to rescue financially distressed companies leads to insolvency which bears negative 'chain consequences' that will affect other members of the society.[5] These negative consequences are not only limited to the companies' shareholders but also affects stakeholders who include employees, suppliers and even customers.[6]

South Africa, Australia, the United Kingdom, and Canada are some of the countries that have adopted a corporate rescue process that can be used to rescue businesses before they become insolvent.[7] This rescue process is called 'corporate rescue' in other jurisdictions, but in South Africa it is referred to as business rescue. The process of business rescue was one of the innovations that was brought forth by the Companies Act 71 of 2008[8] (hereafter referred to as the 2008 Companies Act) and, despite its poor success rate due to various reasons, this mechanism may be very useful to stakeholders and shareholders as some companies have been rescued from financial distress.

Prior to the enactment of the 2008 Companies Act which introduced the process of business rescue, corporate rescue existed in South Africa in the form of judicial management.[9] This corporate rescue process was introduced in South Africa by the Companies Act 46 of 1926[10] and, like business rescue, it dealt with financially distressed companies. Some scholars

[4] Ibid.
[5] Cassim, FHI,Cassim, MF,Cassim et al *Contemporary Company law* 3rd ed (2022) at 1182.
[6] Ibid.
[7] Ibid at 1185.
[8] Ibid at 1181.
[9] A Loubser 'Judicial Management as a Business Rescue Procedure in South African Corporate Law' (2004), 16 (2) *SA Mercantile Law Journal* 137-163 at 140.
[10] Companies Act 46 of 1926.

are of the opinion that South Africa was one of the very first countries to establish this corporate rescue mechanism.[11] It is however unfortunate that, although South Africa had a 'first mover advantage,' it failed to modernise corporate rescue since its inception in 1926.[12] This is evidenced by the fact that the provisions of sections 427 to 440 of the Companies Act 61 of 1973, which dealt with financial distress, were similar to the provisions under the 1926 Act.[13] The only development in the process was the introduction of the moratorium on creditor's claims by the 1939 Act.[14] Judicial management was not a successful rescue mechanism, hence it was replaced in 2008[15] by the business rescue process as per chapter six of the 2008 Companies Act.

It is important to point out that, prior to the enactment of the 2008 Companies Act which introduced business rescue, liquidation was the most common remedy for insolvent companies.[16] Liquidation is still available for insolvent companies. However, liquidation does not ensure the continued existence of a company. Instead, liquidation ultimately results in the winding up of a company. Liquidation often involves the distribution of the assets of an insolvent company to its shareholders and creditors.

Another point to note is that business rescue is not open to all types of companies. A company can only undergo a business rescue process if it meets the requirements set out in the 2008 Companies Act. One such requirement is that the company intending to undergo business rescue should be in financial distress.[17] This is one of the key requirements for business rescue. However, an insolvent company cannot undergo business rescue. The challenge that arises from this is the fact that, there is no statutory definition of what constitutes insolvency. Cassim describes this challenge by pointing out that, the term insolvency is vague and undefined, as it could mean either commercial insolvency or factual insolvency.[18] In *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd*[19],the court held that insolvency refers to commercial

[11]EP Joubert 'Reasonable possibility versus reasonable prospect: Did business rescue succeed in creating a better test than judicial management?' (2013) 76 *Journal of Contemporary Roman-Dutch Law* 505-563 at 551.
[12] Loubser op cit note 9 at 140.
[13] S Krishundutt *A critical analysis of the institution of Business Rescue Proceedings during liquidation proceedings* (published LLM thesis University of Kwazulu-Natal, 2022) at 3.
[14] Ibid.
[15] Companies Act 71 of 2008.
[16] Loubser op cit note 9 at 138.
[17] Section 128 (1) (f) of the Companies Act 71 of 2008.
[18] Cassim et al op cit note 5 at 1187.
[19] *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd* (936/12) [2013] ZASCA 173.

insolvency and not factual insolvency.[20] Thus, it can be argued that 'financial distress' refers to commercial insolvency because that is how the courts have interpreted the requirement.

The other essential requirement as per sections 129 (1)(b) and 131 (4) (a) of the 2008 Companies Act is that the company must have a reasonable prospect of being rescued.[21] A hopeless company that has no reasonable prospect of survival cannot be placed under business rescue because doing so will only waste time and resources. This requirement is also not defined in the 2008 Companies Act but the courts have however attempted to provide various interpretations of this concept. In *Southern Palace Investments v Midnight Storm investments*[22] the court compared the reasonable possibility requirement as per section 427 (1) of the 1973 Act to that of reasonable prospect as per section 131 (4) of 2008 Companies Act. The court's interpretation was that the requirement of reasonable prospect[23] entails less than what was envisaged in the 1973 requirement.[24]

It is also worth stating that that business rescue is only available to companies as they are defined in the 2008 Companies Act. This requirement was dealt with in *Cooperative Muratori v Companies and Intellectual Properties Commission*[25] and will be explored in greater detail herein.

II) RESEARCH QUESTIONS

The crux of this research is to investigate the sufficiency of the requirements of business rescue in addressing corporate rescue in South Africa. This research will also explore other ancillary issues. The goal is to assess whether the requirements for business rescue in terms of the 2008 Companies Act are too strict or whether they serve the intended purpose. Other questions this research will address, which double as guides, are as follows:

I. What is the concept of business rescue and how has this process transformed corporate rescue in South Africa?

II. How are the statutory provisions contained in chapter six of the 2008 Companies Act different from the requirements under the judicial management?

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[20] Ibid para 18.
[21] Section 129 (1) (b) of the Companies Act 71 of 2008.
[22] *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pt) Ltd* [2011] ZAWCHC 442;2012 (2) SA 423 (WCC).
[23] Ibid para 21.
[24] Ibid.
[25] *Cooperativa Muratori & Cementitsi v Companies and Intellectual Property Commission (CMC)* 2021 (3) SA 393 (SCA).

III. What are some of the most common definitions of 'financial distress' and is the South African Company law in line with these definitions?

IV. The three possible outcomes of financial distress are liquidation, business rescue, and a turnaround. What are these outcomes and which one of these is the most common?

V. What is 'a company' in terms of the 2008 Companies Act?

VI. One of the purposes of the 2008 Companies Act is that of encouraging businesses to come and invest in South Africa. Does the requirement that the company being rescued must be incorporated within South Africa (which excludes foreign companies even if they have offices within South Africa) defy this particular purpose of the Act?

III) PROBLEM STATEMENT

The South African business law is ever-changing due to various developments that emerge when new challenges are identified and addressed by the courts, the King Reports on good governance and legislations like the 2008 Companies Act which replaced the 1973 Companies Act. One of the innovations introduced by the 2008 Companies Act is business rescue which is contained in chapter six thereof. Some scholars are of the opinion that its predecessor, the judicial management was not a success.[26] The question that arises since business rescue has been in use for over a decade is whether it has been successful and whether it is meeting the objectives that it was created for. This question arises in the face of an increase of companies filing for insolvency because business rescue has been largely unsuccessful. The purpose of this research is to make a critical analysis of the requirements that must be met in order for a business rescue process to be instituted. The low success rate of business rescue will be investigated, and recommendations will be made to deal with some of the practical challenges of the process. The focus in this research will be the definition of a company, as well as the requirements of financial distress, and reasonable prospect of recovery.

IV) RATIONALE

The rationale of this dissertation is to critically analyse the requirements of the business rescue process. This research strives to provide value to the South African corporate sector by making a critical analysis of the requirements that must be met in order for business rescue to commence and to proceed successfully. The gap that this research will address is as to if these

[26] EP Joubert op cit note 11 at 551.

requirements have been successful in assisting the business rescue process in achieving the objectives for which the 2008 Companies Act was enacted or whether there is a need for any amendments to improve the process.

V) RESEARCH METHODOLOGY

This dissertation will take the form of a desktop research and will make use of online materials and hard copy materials to critically analyse the requirements that must be met for the commencement of business rescue in South Africa in terms of the 2008 Companies Act. The materials that will be used in conducting this research include secondary and primary sources in the form of judgments, legislation and journal articles.

VI) OUTLINE OF CHAPTERS

This dissertation consists of five chapters, the first chapter is the introduction which introduces the reader to the research. Secondly is chapter two which unravels the collaborative forces behind the transformation of South Africa's Corporate law. This is followed by chapter three which will analyse the legal definition of the concept of a "company" under the 2008 Company Act and will investigate one of the prerequisites of business rescue which is that of financial distress. The next chapter, chapter four will critically analyse the other requirement of business rescue which is that of a reasonable prospect. Lastly is chapter five which will conclude this research and also provide recommendations.

CHAPTER TWO

THE NEXUS OF BUSINESS RESCUE: UNRAVELING THE COLLABORATIVE FORCES BEHIND THE TRANSFORMATION OF SOUTH AFRICA'S CORPORATE LAW

I) INTRODUCTION

Prior to the enactment of Chapter six of the 2008 Companies Act, [27] which introduced business rescue in South Africa, some modern economic giants such as Australia, the United Kingdom and Canada had already established statutory mechanisms to assist companies facing financial distress. Akin to the modern-day South African business rescue, these diverse forms of corporate rescue were 'invoked' in specific situations. For example, if it was believed that the insolvency of a company was temporary and that there was potential for the debtor to return,[28] 'to commercial life as an active and successful entrepreneur'[29] then it could be placed under corporate rescue. Rescue mechanisms were advantageous because they could be used to save jobs, to ensure that work that is pending completion is completed in a satisfactory manner, to ensure that debts are paid and to protect investments.[30] An increasing number of countries in the international community embraced and refined their corporate rescue processes and reaped significant benefits from their implementation. This necessitated the adoption and development of a similar process in South Africa. Another reason why the South African legislature was compelled to adopt a new corporate rescue process was the fact that judicial management had proven to be ineffective since its inception in 1926.[31]

The first adoption of business rescue can be accredited and traced back to the eleventh chapter of the United States of America's Bankruptcy Act of 1978.[32] This was followed by the adoption of this process by European countries during the 1980s and the 1990s, by Canada in 1992, and by Australia in 1993.[33] It was becoming evident that business rescue was overdue[34] in South Africa, and that the legal fraternity, and the corporate sector, had to work together to catch up and align with some of the leading countries in the international community.[35] The

[27] Companies Act 71 of 2008.
[28] Section 129 (1) (b) of the Companies Act 71 of 2008.
[29] Harry Rajak and Johan Henning 'Business Rescue for South Africa' (1999) 116(2) *SALJ* 262.
[30] Ibid.
[31] *Le Roux Hotel Management (Pty) Ltd and Another v E Rand (Pty) Ltd (FBC Fidelity Bank Ltd [under Curatorship] intervening)* 2001 (2) SA 727 (CPD) para 60.
[32] US Bankruptcy Act of 1978.
[33] Rajak and Henning op cit note 29.
[34] 'Chapter 6 of the South African Companies Act 71 of 2008 Reviewed' available at *https://www.hg.org/legal-articles/chapter-6-of-the-south-african-companies-act-71-of-2008-reviewed-19587* accessed on the 15th of July 2023.
[35] EP Joubert op cit note 11 at 550.

crystallization of business rescue came as a culmination of the combined efforts made by the Department of Trade and Industry, the recommendations in the King Report amongst other recommendations. This chapter's objective is to define the process of business rescue, to outline how this process came to be in South Africa, and to point out how it has transformed corporate law in South Africa. The significance of this chapter is that it lays out the context necessary for the other chapters and it addresses the main objective of this research which is to critically analyse the requirements of business rescue.

II) WHAT ARE THE CIRCUMSTANCES THAT LED TO THE FORMATION OF CHAPTER 6 OF THE 2008 ACT?

Company law plays a crucial role in every jurisdiction by providing the essential legal foundation for businesses.[36] Its significance lies in enabling wealth creation, enhancing living standards, and driving overall growth within a country. To demonstrate the relationship that exists between company law and businesses, the Government Gazette stated that, 'company law is to business as the shell is to the oyster.'[37] Under the 1973 Act, the company law deeply resembled that of the 1926 Act which was a product of English law since its foundations were deeply rooted in Victorian England whose principles had been established during the nineteenth century.[38] These legal principles were archaic and irrelevant to a modern developing economy like South Africa during the twenty-first century. There was a need for a new Companies Act that would replace the 1973 Act. In addition to this, the English principles in the 1973 Act were being questioned in their country of origin.[39] Therefore, those principles had to be replaced in South Africa, especially because they were failing to satisfy their intended purpose. Furthermore, the need for the replacement of the 1973 Act was also necessitated by the rapid changes in the world such as 'greater globalisation, increased electronic communication, greater sensitivity to social and ethical concerns, fast-changing markets, and greater competition for capital goods and services.'[40] In addition, an increase in international trade and foreign investments demanded the modernisation of company law in South Africa. As a result, it became crucial for the South African lawmakers to draft laws that established a friendly environment for corporate dealings.

[36] The 'South African Company Law for the 21st Century: Guidelines for Corporate Law Reform' (published in *Government Gazette* 26493 of 23 June 2004) 11.
[37] Ibid.
[38] Ibid at 3.
[39] Ibid.
[40] Ibid at 13 para 2.2.1.

One of the main procedures relevant to this research that was contained in the 1926 and 1973 Acts was that of judicial management. The introduction of this rescue procedure in South Africa has often been referred to as a mystery. This is because of the South African legal system's historical tendency to adapt company law developments from the United Kingdom, whereas the first rescue procedure in the United Kingdom was enacted in 1986 way after South Africa's rescue procedure.[41] Despite having a first-mover advantage, South Africa failed to improve the judicial management process. This is evidenced by the fact that since 1926 the process was not amended in any significant manner which necessitated its replacement by the business rescue process provided for in chapter six of the 2008 Companies Act.

Signs of the need for a new corporate rescue mechanism in South Africa can be traced back to the 1970s when judicial management and its low success rates convinced the Master of the High Court that it should be abolished.[42] The Master of the High Court strongly recommended that judicial management be abolished, but the suggestion was met with some resistance by the Van Wyk de Vries Commission of Enquiry which had confidence in its potential as a rescue mechanism. Furthermore, judicial management was criticized for its failure to address its main purpose, which was that of rescuing businesses.[43] One of the scholars that expressed criticism for judicial management was Dr A H Oliver who argued that it was now just an 'unsupervised winding-up.'[44]

A combination of factors such as those mentioned above resulted in the promulgation of the 2008 Companies Act which replaced the 1973 Act. Unlike the old Act's judicial management process which can be described to have been creditor-centric, the new Act[45] created a new corporate rescue process of business rescue which shifts the focus to it being a more debtor-centric process. The challenge with a creditor-centric rescue process is that the focus is not on rescuing the company but rather on protecting creditors during liquation,[46] and this often has negative consequences on the economy and the stakeholders of a company. This is not the case with a debtor-centric approach which strives for the continued existence of the business by rescuing it. The new Act has thus been designed to establish up-to-date company

[41] Rajak and Henning op cit note 29 at 263.
[42] Ibid at 266.
[43] EP Joubert op cit note 11 at 551.
[44] Rajak and Henning op cit note 29 at 267.
[45] Companies Act 71 of 2008.
[46] 'Chapter 6 of the South African Companies Act 71 of 2008 Reviewed' available at *https://www.hg.org/legal-articles/chapter-6-of-the-south-african-companies-act-71-of-2008-reviewed-19587* accessed on the 15th of July 2023.

law that is competitive not only in the South African jurisdiction but also at an international level.[47] Following this reasoning, one can therefore argue that chapter six of the 2008 Companies Act is a statutory provision that is more appropriate for this constitutional democracy's legal, economic, and social context[48] than its predecessor. This is reenforced by the fact that the results of a proper business rescue process are self-evident and are no longer subject to questioning.[49] In addition, chapter six of the 2008 Companies Act strives to lessen the burden of rescuing companies in financial distress. This is done to, 'avoid insolvency and consequent winding-up, and for companies in financial distress to continue operating as commercially viable entities.'[50]

III) WHAT IS BUSINESS RESCUE?

The 2008 Companies Act became operative on the 1st of May 2011, and it brought with it statutory provisions that placed South African company law into alignment with world-class standards.[51] Chapter six of the 2008 Companies Act contains the provisions for the process of business rescue which replaced judicial management. The Insolvency Act 24 of 1936 was the other option that was available for companies in distress and the remedies for companies in financial distress provided for in the Insolvency Act are still available. However, business rescue is the preferred option because of the reasons discussed in this chapter. It has often been held that the options mentioned above, such as judicial management, did not provide sufficient value to our economy as they, did little to restore financial stability in the South African economic environment, or credibility in the business realm.[52] The restoration of a company under these options entailed, 'returning the company to healthy taxpayer status'[53] under judicial management, and under insolvency proceedings, a company would be terminated, 'by dissolution and handed down to an appointed liquidator.'[54] In defining the business rescue process, the core philosophy that underlies this innovative process must be highlighted. The philosophy entails rescuing a company in distress as there is a possibility that a company would be worth more, as a going concern than if it is liquidated with its assets realized on a piecemeal basis.[55] The advantage of this philosophy is that, in as much as the company's creditors are not

[47] Government Gazette op cite note 36 at 4.
[48] Ibid at 7.
[49] Cassim et al op cit note 5 at 1181.
[50] Ibid at 1182.
[51] Peter J Veldhuizen 'What is business rescue?' 2018 8(3) 27 *Corporate Report.*
[52] Ibid.
[53] Ibid.
[54] Ibid.
[55] Cassim et al op cit note 5 at 1182.

guaranteed better returns simply because the company has been subjected to business rescue, there is potential that the creditors might amass better returns, unlike if the company had simply been liquidated. In addition, business rescue allows a business to continue employing people, honouring creditors' claims, and generating income. In respect of the business' assets, they are bound to be worth more if they are used by the rescued company than if they are sold or auctioned. Hence, it is more beneficial to rescue a company than to liquidate it as the latter normally has unintended consequences on the economy and the society. This thus is the reason most South African companies now prefer business rescue to liquidation.

One of the methods to unpack what is meant by the concept of business rescue is to examine the purposes of the 2008 Companies Act. The main purpose of this Act, according to section 7(k)[56] is that it provides a process that makes rescue and recovery more efficient as it seeks to balance the rights and the interests of all the stakeholders involved. The aim is to create an environment that is conducive to economic recovery, especially for companies facing financial distress.[57] The business rescue provisions fulfil one of the objectives the Department of Trade and Industry had in mind when they drafted the new Company law, which was to create a legal system that provides a protective and fertile environment for economic activity.[58] Furthermore, sections 5(1) and section 5(2) reinforce section 7 (k) by extending the scope and advising the courts to consider foreign law where necessary which is important because the South African courts will have insight on how other jurisdictions approach corporate rescue. This edifies our laws in South Africa and is beneficial to our economy in the long run.

Business rescue can also be defined as a process that provides companies in financial distress with a chance for a fresh start and a 'breathing space' which is essential to resuscitate them. This was confirmed in *Southern Palace v Midnight Storm Investments*[59] where the court held that,

> *'The commencement of the Companies Act, no 71 of 2008 ("the new Act") introduced profound changes to the legislation governing companies in this country. One such change is a new remedy available to ailing companies, being business rescue. It constitutes a major theme of the new Act and is amplified in section 7 (k) thereof, which states that one of the purposes of*

[56] Section 7(k) of the 2008 Act 71 of the Companies Act of South Africa.
[57] *Nedbank Ltd v Bestvest 153 (Pty) Ltd, Essa and Another v Bestvest and* Another (21857/201[2012] ZAWCHC 139; 2012 (5) SA 497 (WCC); [2012] 4 All SA 103 (WCC) (12 June 2012) para 1, 2106/2012) 19.
[58] Government Gazette op cit note 36 at 11.
[59] *Southern Palace Investments 265 (Pty) Ltd Midnight Storm Investments 386 (Pty)* Ltd (15155/2011) [2011] ZAWCHC 442;2012 (2) SA 423 (WCC) (25 November 2011) para 1.

the Act is to provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders.'[60]

Another definition of rescue was given by a scholar who defined it as, 'a major intervention necessary to avert the eventual failure of a company.'[61] A more precise definition of rescue is set out in section 128(1)(b) of the 2008 Companies Act. Section 128(1)(b) deals with two possible outcomes that can arise because of business rescue. The first outcome is that of, saving a company as a going concern[62] and the second outcome, which arises in a situation where the company cannot be rescued, is that of restructuring the company in order to, 'produce a return for the company's creditors or shareholders that is better than the return that would have resulted from the immediate liquidation of the company.'[63] The second outcome is in alignment with section 7(k) which seeks to balance the interests and the rights of the relevant stakeholders with those of creditors. Evidently, the definition of business rescue is not confined to 'saving' the company or simply restoring it to solvency, but it is also a process that considers better returns for stakeholders.

In *Collard v Jatara*[64] the business rescue application was aimed at ensuring better returns for the shareholders and the company's creditors. According to the business plan in this case, rescue entailed ensuring that the employees were paid their claims in full and that the creditors would get better dividend than they otherwise would if the company were to be wound up.[65] The court confirmed the position that getting dividends for the company's creditors is a legitimate purpose of business rescue.[66] The court echoed the notion that a successful business rescue is beneficial because employees, who are one group of creditors, get paid in full. This aligns with section 7(k) of the 2008 Companies Act's position which seeks to balance the rights of all stakeholders. Creditors will also amass better returns than they would if the route of liquidation had been taken.[67] Section 128 (1)(h) of the 2008 Companies Act reinforces what 'rescue' is, and it expresses that the above objectives must be achieved for a process to be regarded as a proper business rescue process.

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[60] Ibid.
[61] Alice Belcher *Corporate Rescue: A Conceptual Approach to Insolvency Law* (1997) 4.
[62] Cassim et al op cit note 5 at 1184.
[63] Ibid.
[64] *Collard v Jatara Connect (Pty) Ltd and Others* (23510/2016) [2017] ZAWCHC 45; 2018 (5) SA 238 (WCC) (14 March 2017).
[65] Ibid para 6.
[66] Ibid para 7.
[67] Ibid paragraph 1.

It is also important to point out that business rescue does not mean merely preserving the company as an empty shell.[68] In *Oakdene Square Properties v Farm Bothasfontein (Kyalami)* [69] the court ruled in favour of the second and the third respondents and held that the rescue proceedings in question were inappropriate. The court held that the application did not amount to business rescue as outlined in section 128 (1)(b)(iii) because the business rescue envisaged by the applicants would only facilitate the continued 'existence of the business of the company on a solvent basis.' The court held that if a company only exists to own cash in the bank it loses its 'raison d'etre,'[70] or its reason for being, and, since there was no business of the company that was to be rescued, a business rescue application could not succeed.

In *Gormley v West City Precinct*[71] the court also dealt with the disqualification of a company from undergoing a business rescue process. In that case, the applicant made an application to place the first respondent under business rescue based on the fact that there would be a reasonable prospect of its recovery if first respondent's obligations were suspended for three to five years. The court held that the application could not succeed since the application had been made with no prospects of rehabilitating the company to rescue it, or for its continued existence as an economic entity. Rather, the intended purpose of the application was to merely realise the assets of the company over an extended period.[72] The application had solely been made to secure a moratorium, which is an inherent consequence of business rescue. After a careful consideration, the court dismissed the application for business rescue with costs as it failed to satisfy the statutory definition of 'rescue' outlined in section 128 (1)(h) of the Act. It is arguable that the application was an attempt to abuse the business rescue process. In *FirstRand Bank Limited v Normandie Restaurants Investments,*[73]the court held that business rescue is a process that:

> *'...envisages a plan aimed at rescuing the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximizes the likelihood of the company continuing in existence on a solvent basis, and where this is not*

[68] Cassim et al op cit note 5 at 1184.
[69] *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* (609/2012) [2013] ZASCA 68; 2013 (4) SA 539 (SCA); [2013] 3 All SA 303 (SCA) (27 May 2013).
[70] Ibid para 39.
[71] *Gormley v West City Precinct Properties (Pty) Ltd and Another* (19075/11, 15584/11) [2012] ZAWCHC 33 (18 April 2012).
[72] Ibid para 12.
[73] *FirstRand Bank Limited v Normandie Restaurants Investments* (189/2016) [2016] ZASCA 178 (25 November 2016).

possible, to maximize return for the company's creditors or shareholders than would otherwise be the case from the immediate liquidation of the company…'[74]

The South African courts have, therefore, established sound legal precedents in support of reorganizing and restructuring companies in financial distress.[75] This has helped to assist some companies to get out of debt and avoid liquidation. From the definitions that have been given of business rescue above, it is evident that business rescue is a better and a preferable alternative to liquidation hence the use of business rescue in this jurisdiction is on a steady rise. Table B.4 of CIPC's annual report of 2022 serves as evidence that there has been a steady rise of companies that have applied for business rescue and a drop in companies that have been liquidated.[76] The total number of business rescue proceedings from 2011 to 2022 was 4305, with 50 active business rescue proceedings during the 2011-2012 period and 296 active business rescue proceedings during the 2021-2022 period.[77] It is also evident from this table that the number of companies that have gone through liquidation has since dropped with 58 liquidation proceedings during the 2011-2012 period and only nine during the 2021-2022 period.[78] The total number of companies that have ended up in liquidation since the business rescue process was implemented amounts to only 546 businesses,[79] an amount that would have been higher if not for some companies going through the business rescue process. However, it is important to reemphasize that this rescue opportunity is only available to certain companies under certain circumstances. These circumstances, or requirements, will be examined in the following chapters of this research, and they include financial distress, a reasonable prospect of the company getting rescued within the prescribed period, and that the company must be a company as pointed out by the Act.[80]

In defining business rescue this chapter has identified some of the pros of this process but it goes without saying that, in as much as business rescue has many advantages and has demonstrated some level of success, this process unfortunately has its cons that are known to lead to frustration.[81] One of the main cons of chapter six is the powers conferred on directors

[74] Ibid para 21.
[75] Ibid.
[76] Companies and Intellectual Property Commission *Annual Report* (2021/2022) 35.
[77] Ibid.
[78] Ibid.
[79] Eric Levenstein 'The Status of Business Rescue in South Africa '-October 2022, available at *https://www.werksmans.com/legal-updates-and-opinions/the-status-of-business-rescue-in-south-africa-october-2022/* accessed on 24 Jul 2023.
[80] Eric Leveinstein 'Business rescue in South Africa: shortcomings, suggestions and possible amendments to Chapter 6 of the 2008 Companies Act' 2018 8 (2) *Corporate Report* 8.
[81] Ibid at 10.

which are prone to abuse. Under the 2008 Companies Act, directors have the authority of placing a company voluntarily under business rescue, which is one of the two ways in which business rescue can commence. The weakness of the present business rescue legislative provision is that it affords directors too much power to commence business rescue whereas, often directors have no real understanding of the level of the company's financial distress, nor do they have a sustainable plan to rescue the company.[82] This makes the commencement of business rescue under this option susceptible to abuse and may prejudice interested parties such as creditors. One of the solutions proposed to deal with this weakness is to make it mandatory to establish a team that will make a pre-assessment which will determine whether a company is indeed in financial distress, and whether there is a reasonable prospect of rescuing the company .[83] The findings of this team should be presented to the board of directors for their consideration before the commencement of the business rescue proceedings. Another way a company can be placed under business rescue is through a compulsory commencement of business rescue, and there is some uncertainty with this option as well. The uncertainty with compulsory commencement is whether business rescue commences when an application has been made to the court in terms of section 131(1) or when the court has granted an order for the commencement of business rescue. The above cons are some examples of the grey areas of business rescue that have often caused frustration. These frustrations have prompted stakeholders to propose amendments to the existing legislation. The proposed changes aim to provide a clearer and more user-friendly definition of the business rescue process that would facilitate its practical implementation.[84]

IV) HOW HAS BUSINESS RESCUE TRANSFORMED CORPORATE LAW IN SOUTH AFRICA?

The introduction of business rescue transformed the corporate sector as it brought a rescue process that had not been previously available. In other words, it introduced a different *modus operandi* for how companies can be rescued. Unfortunately, this process has often been criticised for its low success rates which are caused by numerous variables.[85] One of the main reasons for the low success rate of business rescue is the 'ostrich syndrome.'[86] This refers to a

[82] Ibid.
[83] Ibid.
[84] Ibid.
[85] Ibid.
[86] Carrim Smith 'Business rescue success hampered by ostrich syndrome and 'rogue operators'' News 24 2 August 2020 available at *https://www.news24.com/fin24/economy/business-rescue-success-hampered-by-ostrich-syndrome-and-some-rogue-operators-20200802* accessed on 24 July 2023.

situation where directors struggle to acknowledge the commercial reality that their companies cannot be rescued but still place their companies under business rescue. Other reasons for the low success rate of business rescue in South Africa include the complexity of the process, financial constraints, lack of understanding and awareness, resistance from creditors and stakeholders, and limited timeframe.[87] However, there has been an improvement in the success rate of business rescue. For instance, in 2022 the success rate was at nineteen per cent[88] which was an increase from a twelve per cent success rate during the period between May 2011 and March 2014, and fifteen per cent in June 2016.[89]

Furthermore, business rescue has transformed the corporate sector in South Africa as businesses now have a rescue mechanism that private and public companies can utilize. It is worth pointing out that in 2022, there was a significant drop in the number of companies that filed for rescue, and, of all the companies that got into business rescue, eighty per cent were private companies, fifteen per cent were close corporations, and none of them were state-owned enterprises.[90] In addition to this, in 2022, an approximately fifteen notices of substantial implementation of the adopted business rescue plan were filed. This serves as evidence that 'business rescue remains a viable option for financially distressed companies.'[91]

Moreover, business rescue has transformed corporate rescue in South Africa by promoting the economy through job preservation and adherence to international standards for rescuing financially distressed companies with reasonable prospects of recovery. Noteworthy examples of prominent companies that have undergone this process include Edcon, Consolidated Infrastructure Group, Southgold Exploration, Tongaat Hulett, South African Airways, Optimum Coal, and Ster Kinekor. The successful rescue of these companies has saved thousands of jobs that would have been lost if the companies were liquidated. However, as pointed out before, not all companies that go through business rescue are resuscitated back to life.

Business rescue transformed corporate rescue by introducing a different philosophy from that of judicial management.[92] To explain how the philosophies differ, the South African

[87] Eric Levenstein op cit note 80.
[88] Eric Levenstein op cit note 79.
[89] Talira Naidoo, Adnan Patel and Nirupa Padia 'Business rescue practices in South Africa: An explorative view' (2018) 11 *Journal of Economic and Financial Sciences* 2.
[90] Eric Levenstein op cit note 79.
[91] Ibid.
[92] Cassim et al op cit note 5 at 1212.

business rescue is to be compared to other jurisdictions. For example, section 137(2) (a) of the 2008 Companies Act is closely related to the English approach of management displacement[93] whereby directors are required to continue serving in their roles subject to the authority of a business rescue practitioner. According to the approach of management displacement, the power to manage the affairs of the debtor company is taken away from the board of directors and given to the administrator. [94] This stripping away of the management's powers arises because the company's financial distress status is usually a consequence of the mismanagement of a company's affairs by the management team. By contrast, under the American approach, the management of the company remains in control of the company and of the company's assets.[95] The rationale for the American approach is that managers remain in control because they are more acquainted with the affairs of the company than the newly appointed rescue practitioner.

V) CONCLUSION

In summary, this chapter sought to define business rescue, to point out how it came to be and how it transformed corporate law in South Africa. Various case laws were used to define what business rescue is and what it is not. A short definition that summarises business rescue is that it is a process through which a company that meets the requirements is granted a moratorium on performing its obligations which enables a rescue practitioner to rescue the company from its financial demise. This concept of business rescue is a product of the combined efforts that were made to fulfil several objectives that had been set out by bodies such as the Department of Trade and Industry. In respect of how this rescue mechanism has transformed corporate law in South Africa, it has been pointed out that business rescue has had some success over the years since its adoption into South African law which has aligned our corporate rescue with some of the major economies in the international community. This process has shifted the focus from a creditor-centric process that favoured the winding up of a company to a debtor-centric process that strives to strike a balance between the debtor and its stakeholders. Rescuing a company is more advantageous to the creditors as they get better returns compared to what they could have obtained from liquidation. Furthermore, this chapter covered how business rescue has transformed corporate law and highlighted that this process established a rescue mechanism that did not exist in South Africa before the enactment of the 2008 Companies Act. In addition,

[93] UK Enterprise Act of 2002.
[94] Cassim et al op cit note 5 at 1212.
[95] Ibid.

this chapter also pointed out the fact that business rescue in South Africa has experienced an exceptionally low success rate, but the success rate has been improving since its inception. The business rescue process, unlike its predecessor of judicial management, strives to save employees' jobs, which is beneficial to the economy. Business rescue also makes use of an underlying management philosophy which is different from that of the American business rescue, but remarkably similar to that of the United Kingdom. The next chapter of this research will go a step further into addressing some of the key objectives of this research. It will unpack the definition of a company under the 2008 Companies Act, define the requirement of financial distress and point out the possible courses of action that can be taken by a company in distress.

CHAPTER THREE

AN ANALYSIS OF THE LEGAL DEFINITION OF A COMPANY UNDER THE 2008 COMPANY ACT AND THE PREREQUISITE OF FINANCIAL DISTRESS IN BUSINESS RESCUE

I) INTRODUCTION

South Africa's economic position on the global stage as an emerging economy and a member of the BRICS organisation is unique. The South African economy has a unique contrast between challenges like loadshedding, rising inflation, high unemployment, and the emerging opportunities of its association with some of the biggest economies in the world.[96] This jurisdiction has been experiencing an increase of shareholder activism in recent years, exposure to highly developed capital markets and sophisticated legislative and governance regulations.[97] One such sophistication of legislation is the concept of business rescue which was introduced by the 2008 Companies Act as discussed in the previous chapters. It is essential to reiterate that the introduction of the 2008 Companies Act, was in part a response to address the prevalent issue of corporate failures in South Africa. A notable example of such corporate failures within this jurisdiction at the turn of the century is the Fidentia Scandal.[98] It is unfortunate that, despite the reforms introduced, such as the introduction of the 2008 Companies Act, corporate failure continues to persist within this jurisdiction. This is evidenced by the recent corporate failures that fuelled the distress of capital markets and further damaged public trust in South Africa. Such corporate failures include that of African Bank Limited in 2014 which failed due to severe debt, Group Five Ltd which collapsed in 2019 because of significant financial losses and Steinhoff International in 2017. One could contend that some of these corporate failures are consequences of the failure to take redress in instances where companies become financially distressed.

The provision of a remedy for financially distressed companies to avoid liquidation[99] is one of the purposes of the 2008 Companies Act. This new Act is governance-centric, and it

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[96] Gareth Cremen 'Businesses are under pressure to survive the South African economy strained by continuous blackout' available at *https://www.engineeringnews.co.za/article/businesses-are-under-pressure-to-survive-the-south-african-economy-strained-by-continuous-blackouts-2023-05-30* accessed on the 7th of June 2023.
[97] Navitha Singh Sewpersadh 'An econometric analysis of financial distress determinants from an emerging economy governance perspective' (2022) 10 *Cogent Economics & Finance* 2.
[98] Martin Hesse 'Why the Fidentia saga shook SA to the core' available at *https://www.iol.co.za/personal-finance/financial-planning/why-the-fidentia-saga-shook-sa-to-the-core-310d4602-2d56-4361-8e21-feecc42980d2* accessed on the 8th of June 2024.
[99] Maleka Femida Cassim 'South African Airways makes an emergency landing into business rescue: Some burning issues' (2020) 127(2) *South African Law Journal* 201.

strives to minimise the risks that are associated with financial distress and corporate demise.[100] The rehabilitation of a financially distressed company is done through business rescue. However, there are certain requirements that have to be satisfied for its commencement. These requirements are that the entity that wants to be rescued must be a company as defined in the Act, it must be financially distressed and there has to be a reasonable prospect of the company's recovery. The main objectives of this chapter therefore are to unpack the definition of what constitutes as a company under the Act, defining the requirement of financial distress, and explaining the three possible courses of action that can be taken by a company that is in a state of financial distress. The other main requirement needed for the commencement of business rescue will be discussed in the next chapter.

II) WHAT QUALIFIES AS A COMPANY UNDER THE COMPANIES ACT?

The requirement that a company should be a company as highlighted by the Act may be characterized as a latent requirement. However, regardless of this requirement being a 'silent requirement', it was the subject of contention in *Cooperativa Muratori & Cementitsi v Companies and Intellectual Property Commission (CMC).*[101] According to this case the definition of a company is:

> *'a juristic person incorporated in terms of this Act, a domesticated company, or a juristic person that, immediately before the effective date- (a) was registered in terms of the- (i)Companies Act, 1973 (Act No 61 of 1973), other than as an external company as defined in the Act or ii) Close Corporations Act 1984 (Act No.69 of 1984), if it has subsequently been converted in terms of Schedule 2. (b) was in existence and recognized as an 'existing company' in terms of the Companies Act, 1973 (Act No.61 of 1973) (c) or was deregistered in terms of the Companies Act, 1973 (Act No.61 of 1973) and has subsequently been re-registered in terms of this Act,'*[102]

It is clear from this definition that foreign companies are not incorporated within the Republic of South Africa. These types of companies are, therefore, excluded from the definition of a company as defined by the Act. The rationale for this exclusion of foreign companies from various provisions contained within this Act according to Hayath[103] is to

[100] DR GH Muller, Prof BW Stern-Bruwer,Prof WD Hamman,'What is the best way to predict financial distress of companies?' Leaders' Lab 2012 available at *https://www.leader.co.za/article.aspx?s=6&a=4349* accessed on 14 August 2023.
[101] *Cooperativa Muratori & Cementitsi* supra note 25.
[102] Section 1 of the Companies Act 71 of 2008.
[103] Iram Hayath 'A case for excluding foreign companies from the application of the companies Act of 2008 is unconvincing' *(*2021) 8(1) *Journal of Corporate and Commercial Law and Practice* 67-85.

satisfy the purposes of the Act, namely the promotion of innovation and investment in South Africa.[104] However, it can be argued that the exclusion of foreign companies from various provisions of the 2008 Companies Act bears some negative effects in some instances. Such negative effects include the fact that foreign companies or external companies are excluded from enjoying statutory provisions that they could have benefited from, the most relevant being that of business rescue.[105] Only certain specific sections of the Act are extended to external companies under the 2008 Companies Act, and this is a huge change to the position that existed in the Companies Act 61 of 1973. The old Act applied to companies that had been incorporated under the 1973 Act, as well as every external company (except for instances where the Act stated otherwise). [106] The position under the 2008 Companies Act is thus different from the 1973 Act in that only certain specific sections of the Act are extended to external companies.

In *Cooperativa Muratori & Cementisti v Companies and Intellectual and Property Commission*[107] the court emphasized that only a company as defined in the 2008 Companies Act could be placed under business rescue. The appellant, Coorperativa Muratori, was an international construction company that was incorporated in Italy. Unfortunately, the company was resolved to be financially distressed on the 14th of December 2018 in South Africa, which led to the appointment of business rescue practitioners to rescue it. The Companies and Intellectual Property Commission (CPIC) challenged the steps that had been taken by this company to be placed under business rescue. The CPIC's challenge was based on the fact that the company was an external company and could not be placed under business rescue in this jurisdiction. The SCA held that the South African business rescue procedure cannot be used by external companies incorporated elsewhere, even if the companies are registered as a external companies in South Africa.[108] This is because external companies did not satisfy the definition of a company as per section 1 of the 2008 Companies Act.

The court's decision in *Cooperativa Muratori & Cementitsi v Companies and Intellectual Property Commission (CMC)* aligned with Cassim's observation in respect of the 2008 Companies Act.[109] This observation was that the legislative intent of the 2008 Companies Act was, 'to reduce the regulation of external companies to promote investment in South

[104] Section 1 of the Companies Act 71 of 2008.
[105]Iram Hayath op cit note 103 at 67.
[106] Section 2 (2) of the Companies Act 61 of the 1973.
[107] *Cooperativa Muratori & Cementitsi* supra note 25.
[108] Adnre Boraine 'Formal debt-relief, Rescue and Liquidation options for external companies in South Africa' (2020) 7 (4) *BRICS Law Journal* 89.
[109] Cassim, FHI,Cassim, MF,Cassim et al *Contemporary Company law* (2012) 2nd ed 97-8.

African markets.'[110] It can be contended that this observation confirms the position that there indeed is a 'paradigm shift'[111] from the 1973 Act which gave external companies a similar treatment to that of South African companies, in comparison to the position under the 2008 Companies Act which reduces the over-regulation of external companies in order to cut the red tape so as to entice external companies.[112] Furthermore, one can argue that the cutting of the red tape is consistent with the objectives or the purposes of the 2008 Companies Act as set out in section 7 thereof. [113] However, it can also be argued that these exclusions have had negative effects in instances which stifle the innovation that they intend to protect because external companies cannot enjoy some statutory provisions that companies incorporated in South Africa enjoy such as business rescue.

Although not often discussed by scholars, it can be argued that the requirement that a company must be a 'company' as defined by the 2008 Companies Act is indeed one of the key requirements of business rescue. The purpose of this requirement is to reduce the type of companies that can be subjected to a business rescue process.

III) DEFINING FINANCIAL DISTRESS

The next objective of this chapter is to define the requirement of financial distress which is one of the two major requirements needed for the commencement of the business rescue process. This requirement is often described as the trigger for business rescue proceedings. The factors that frequently contribute to a company's distress include poor corporate governance practices, and inadequate cash flows. Poor corporate governance has long been attributed to be a result of a company's pursuit of short-term profits as it diverts decision-makers from making sustainable choices, to making decisions that may compromise the interests of the company, its stakeholders, and its shareholders.[114] Inadequate cash flows can be attributed to factors such as technological advancements, emerging competitors, and market maturity, among others.[115] The unfortunate consequence of companies experiencing insufficient cashflows is that, if this issue is not addressed, it leads to bankruptcy and eventually liquidation.[116] When a company

[110] Ibid at 97.
[111] Adnre Boraine op cit note 108 at 97.
[112] Cassim et al op cit note 109 at 98.
[113] Section 7 of the Companies Act 71 of 2008.
[114] Navitha Singh Sewpersadh op cit note 97 at 1.
[115] Ibid at 3.
[116] Ibid.

faces insufficient cash flow, it serves as an indication of the company's state of financial distress.

The concept of financial distress has often been criticized for lacking consensus when it comes to its definition the world over.[117] This is so because there are a few definitions of this concept that have been proposed by different researchers in different jurisdictions. It would be beneficial to take a multifaceted approach that will consider the definition of financial distress by various researchers as this will assist in providing a better understanding of this concept. However, the most important definition of this concept for the purposes of this research is the one that is provided by the South African legislature.

One of the earliest definitions of financial distress was given by Beaver, a scholar who modelled, classified and predicted corporate bankruptcy.[118] Beaver's definition of financial distress encompassed various conditions such as bankruptcy, insolvency, liquidation initiated for creditor benefit, default of loan obligations, or failing to meet preferred dividend payments.[119] Handel offered another compelling definition of this concept,[120] by characterising financial distress as the probability of bankruptcy, contingent upon the level of liquid assets and the availability of credit.[121] Andrade and Kaplan defined financial distress as, a default on a debt situation and an attempt to restructure the debt in order to prevent the default situation.[122] All these definitions have a common undertone, namely a company's failure or inability to discharge its financial obligations. The simplest definition of this concept was provided by Wang and Senbet[123] who described financial distress as arising in an instance where a firm makes promises to its creditors, but those promises are broken or honoured with difficulty.[124]

In the South African context, financial distress assumes a paramount significance when it comes to the process of business rescue. This concept serves as a pivotal catalyst for business rescue, as a company that is not in a state of financial distress cannot initiate this process.[125]

[117] DR GH Muller op cit note 100.
[118] Ibid.
[119] Ibid.
[120] Rajerandra Rajaram *Success factors for business rescue in South Africa* (LLD thesis University of Kwazulu-Natal,2016) 25.
[121] Ibid.
[122] Ibid.
[123] Lemma W Senbet and Tracy Yue Wang 'Corporate Financial Distress and Bankruptcy: A Survey' (2010) 5(4) Foundations *and Trends in Finance* 7.
[124] Ibid at 7.
[125] Cassim op cit note 5 at 1185.

The 2008 Companies Act provides that a company is deemed to be financially distressed if it appears reasonably unlikely to meet all its debts as they become due and payable within the forthcoming six months or if it appears reasonably likely to become insolvent within the same timeframe.[126] An interesting point to highlight in this definition is the observation that was made by Cassim who proposed that the use of the word 'appears' in section 128 (1) (f) meant a standard of proof that is lower regarding matters before the court that must be satisfied.[127]

The original[128] definition of financial distress in the Bill included that a company would be financially distressed as first possibility[129] if it were, unable to pay its debt as they fall due and payable, and its liabilities exceed its assets.[130] It bears mentioning that the definition of financial distress in the 2008 Companies Act is similar to the definition of distress that was given by the scholar Gordon. According to this scholar, financial distress signals that the company's earning power is on a decline which increases the probability that that company may not settle its obligatory payments of interests and debt capital consequently affecting its credit risk profile.[131] Considering the various definitions of financial distress provided thus far including the definition under the South African legislature it is evident that they have similar undertones as these definitions echo the same thing which is that of a company struggling to meet its financial obligations that it owes its creditors.

IV) THE DEVELOPMENT OF FINANCIAL DISTRESS IN SOUTH AFRICA

To further explain the concept of financial distress, it is imperative to conduct a comprehensive assessment of its historical evolution within the South African context. The initial point of consideration involves an examination and discussion of the diverse submissions pertaining to financial distress that were made to the Portfolio Committee on Trade and Industry (PCTI) as the concept of financial distress developed.[132] Loubser's submission, which was accepted by the Portfolio Committee, stated that there was no discernible reason why a double insolvency test – both commercial and actual – should be set when the resolution (or court order) was based on the present financial situation of the company, but only one of the two was required when it was based on the company's expected situation in the six months immediately

[126] Section 128 (1) (f)(ii) of the Companies Act 71 of 2008.
[127] Cassim op cit note 5 at 1187.
[128] Companies Bill 2008.
[129] Anneli Loubser *Some comparative aspects of corporate rescue in South African company law* (published LLD Thesis UNISA ,2010) 56.
[130] Ibid.
[131] Gordon, M. J 'Towards a theory of financial distress' (1971) 26(2) *The Journal of Finance* 347–356.
[132] Anneli Loubser op cit note 129 at 57.

following.[133] The significance of this submission is that it contributed to the removal of the first option in the test for financial distress which was based on the company's present financial situation.[134] KPMG Auditors suggested that there should be an increase of the six-month period contained in the financial distress test to twelve months.[135] The proposal was rejected by the Portfolio Committee on Trade and Industry which explains why six months is still the stipulated period in the test for financial distress.[136] The six-month period has been criticized by scholars for being too short which has the effect of possibly depriving a company enough time to take steps to protect itself.[137] The argument made by some scholars in favour of the twelve-month period is based on the fact that the financial planning of a company usually stretches over the next (financial) year.[138]

V) FINANCIAL DISTRESS UNDER JUDICIAL MANAGEMENT VERSUS UNDER BUSINESS RESCUE

The concept of financial distress involves a comparative analysis of instances of financial distress occurring within the framework of judicial management and those falling within the ambit of business rescue. One can contend that the concept of financial distress under the 2008 Companies Act has improved significantly as compared to under judicial management. A noticeable difference of financial distress in relation to business rescue, and its predecessor in relation to judicial management is that, for a company to be regarded as being in a state of financial distress under judicial management, that company was required to be already unable to pay its debts[139] whereas under business rescue it is not a prerequisite for companies to be in dire positions to qualify as financially distressed for the process of business rescue to commence. This position was supported in *Welman v Marcelle Props* [140] where it was held that business rescue was not meant for 'terminally' or 'chronically ill' companies, but it was meant for ailing companies that can be rescued provided they have been given time.[141] The definition of financial distress under the new Act therefore, improves companies' prospects of survival, placing them in a more favourable position compared to those under judicial management

[133] Ibid.
[134] Ibid.
[135] Ibid at 58.
[136] Section 128 (1) (f)(ii) of the Companies Act 71 of 2008.
[137] Anneli Loubser op cit note 129 at 58.
[138] Ibid.
[139] Ibid.
[140] *Welman v Marcelle Props* 193 CC [2013] JOL 30620 (GSJ) 12 par 28.
[141] Ibid.

where companies were required to be wholly incapable of servicing their debts [142] to qualify as being financially distressed.

VI) THE TWO LIMBS OF FINANCIAL DISTRESS

The definition of a financially distressed company in the South African legislature is contained in section 128 (1) (f) of the 2008 Companies Act. This definition of financial distress has two limbs or tests. The first limb is that of commercial insolvency or the cash flow or liquidity test which refers to insolvency in regard to the company being unable to pay its debts as they fall due.[143] The second limb or test is factual insolvency or insolvency in the balance-sheet sense, namely liabilities exceeding assets.[144] Levenstein is of the opinion that these tests are in sync with the international standards required for companies to be eligible to go under the rescue procedure.[145]

a) The first limb

In relation to commercial insolvency, or the cash flow test, Cassim suggests that the assessment for this criterion should extend beyond determining a momentary inability to pay solely due to a lack of liquidity.[146] Rather, Cassim proposes that the cash flow insolvency should be determined by the entire company's financial position. This requires consideration of the cash resources available to the company for instance through borrowing funds or selling its assets or through acquiring financial support from a related entity (in instances of state-owned enterprises acquiring support from the government).[147] Cassim also expresses that another factor that can be considered when it comes to dealing with this limb is that of the agreements that a company can have with its creditors to extend the trading terms. Some of the most relevant cases dealing with financial distress, and in particular the test for commercial insolvency, include *Oakdene Square Properties v Farm Bothasfontein* [148] and *Al Mayya International v Valley of the Kings Thaba Motswere* case.[149] The courts in both these cases confirmed the position that, although the company can be factually solvent in that the value of its assets exceeded its debts, if it was unable to satisfy the judgement debt it was commercially

[142] Vander Merwe *Requirements to commence business rescue proceedings* (LLM thesis University of Pretoria,2018) 40.
[143] Ibid at 41.
[144] Cassim et al op cit note 5 at 1185.
[145] Eric Levenstein *An appraisal of the new South African business rescue procedure* (LLD thesis University of Pretoria,2015) 79.
[146] Maleka Femida Cassim op cit note 99 at 206.
[147] Ibid.
[148] *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* 2012 (3) SA 273 (GSJ).
[149] *Al Mayya International Ltd (BVI) v Valley of the Kings Thaba Motswere (Pty) Ltd* [2016] para 30.

insolvent for liquidation purposes, and it was 'financially distressed' within the meaning of the Act.

In *Oakdene Square Properties v Farm Bothasfontein* [150] the court held that business rescue was not the preferred option but rather the winding up of the company.[151] The court reached this conclusion on the basis that the proposal that had been made by the appellants in respect of rescuing the company did not constitute business rescue within the meaning of section 128 (1)(b)(iii). A company can be financially distressed within the contemplation of section 134 (4)(a)(i) irrespective of it appearing to be factually solvent or its assets exceeding its liabilities. A commercially insolvent company, despite being factually solvent, is considered to be in a state of financial distress.[152] However, the South African courts have not yet made deliberations on whether a company that is factually insolvent though commercially solvent would be in financial distress.[153]

In *Al Mayya International v Valley of the Kings Thaba Motswere* [154] the applicant wanted to place the first respondent under business rescue proceedings in terms if sections 131 (1) and (4) of the 2008 Companies Act the applicant owned 55 per cent of the shares in the respondent. The court held that the applicant had to show that the first respondent was financially distressed within the meaning of section 128 (g) of the Act. One of the factors that served as evidence that the company was indeed financially distressed was the fact that it struggled to make ends meet to the extent that it was not in a position to pay the wages of its employees. The court's interpretation was similar to that made in *Oakdene Square Properties v Farm Bothasfontein*[155] where, although the company was factually solvent, its failure to satisfy the judgement debt made it commercially insolvent for liquidation purposes and meant that it was financially distressed.

b) The second limb

The second limb of financial distress is 'insolvency in the balance-sheet sense.' This limb has often been regarded to be problematic by some scholars because of the vagueness of the term 'insolvent' which can either mean commercial insolvency or factual insolvency.[156] A

[150] *Oakdene* supra note 134.
[151] Ibid at para 39.
[152] Ibid para 7.
[153] Maleka Femida Cassim op cit note 99 at 206.
[154] *Al Mayya* supra note 149.
[155] Ibid para 30.
[156]Cassim et al op cit note 5 at 1187.

proposed solution to this vagueness was given in *Boschpoort Ondernenmings (Pty) Ltd v ABSA Bank Ltd*[157] where the court held that insolvency refers to commercial insolvency. However it is important to note that, factual solvency will always be a factor in deciding whether a company is unable to pay its debts.[158] In support of this notion, Cassim argued that the definition of financial distress in s 128(1)(f)(ii) requires the courts to adopt an approach that is holistic when it comes to assessing if the company is insolvent or close to becoming insolvent.[159] In addition to this, this scholar also argued that, to yield sensible results, the two limbs or the 'twin-tests' should not be dealt with in isolation but should work shoulder to shoulder. What this means is that the two limbs must work in tandem for them to operate effectively for the purpose of instituting business rescue. It is worth pointing out that although the issue in *Boschpoort Ondernenmings (Pty) Ltd v ABSA Bank Ltd* case was on the winding up of a company it can be used for persuasive purposes when dealing with business rescue related issues particularly when interpreting the meaning of insolvency under the second limb of financial distress.[160]

In *BNY Corporate Trustee Services Limited and others v Eurosail,*[161] the court held that when trying to prove that a company is struggling to pay its debts because, the value of the company's assets is less than the amount of its liabilities considering its contingent and prospective liabilities (also known as balance sheet insolvency), the wider commercial context must be put into consideration. The court emphasised that when determining factual insolvency, a court cannot simply be satisfied with the fact that the liabilities exceed assets. The court must consider factors beyond the assets and liabilities that would have been used in the preparation of company statutory accounts. The relevance of this court's decision in this case is that it aligns with Cassim's position which advocated for cash flow insolvency to be determined by the entire company's financial position.[162]

VII) THE POSSIBLE COURSES OF ACTION THAT CAN BE TAKEN BY A COMPANY IN FINANCIAL DISTRESS

There are three courses of action that can be taken by a company in financial distress, namely a legislated rescue, a turnaround and liquidation.[163] As already discussed in this chapter,

[157] *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd (*936/12) [2013] ZASCA 173.
[158] Cassim et al op cit note 5 at 1186.
[159] Maleka Femida Cassim op cit note 99 at 208.
[160] Cassim et al op cit note 5 at 1186.
[161] *Bny Corporate Trustee Services Ltd v Eurosail-UK 2007* 3BL Plc [2013] UKSC 28.
[162] Cassim et al op cit note 5 at 1185.
[163] Rajendra Rajaram op cit note 120 at 27.

business rescue can only be triggered by financial distress. A second course of action that can be taken by a company in a state of financial distress is that of a turnaround, which can be described as a recovery of an organization's economic performance following an existence-threatening decline.[164] In 2020/2021 post Covid pandemic, this course of action had R 104 million at its disposal which sought to assist more than 174 companies that were experiencing financial distress because of the pandemic.[165] The process of business turnaround and recovery in this jurisdiction prides itself on having saved over 145000 jobs since its inception.[166] The alternative course of action, which is arguably the worst of all the three and should be avoided by all companies to avoid business closure, is that of liquidation. This route has been described by some scholars to be the ultimate exit strategy for a financially distressed company.[167] In *Richter v ABSA Bank Ltd*,[168] the court held that liquidation is the process by which a company is brought to an end and if it has assets, they are redistributed.[169] These therefore are the three remedies available to companies in financial distress.

VIII) CONCLUSION

In summation, based on the position that was held by the court in *Cooperativa Muratori & Cementitsi v Companies and Intellectual Property Commission (CMC)*, and the definition of a company as provided by section 1 of the Companies Act of 2008, it is evident that not all companies that operate in South Africa can go under the process of business rescue. The definition of a company in terms of the 2008 Companies Act excludes foreign companies operating in South Africa. This excludes those companies from the protection provided for in the 2008 Companies Act, such as business rescue. In addition to this, it has been pointed out that the exclusion of foreign companies is a major change to the position that existed in the 1973 Companies Act which gave external companies similar treatment to that of South African companies. The exclusion serves the purpose of reducing the number of companies that can be subjected to business rescue which has both pros and cons.

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[164] Balgobin, R. & Pandit, N 'Stages in the Turnaround Process: The Case of IBM UK' (2001) 19(3) *European Management Journal* 301.

165 How the Business Turnaround and Recovery can help companies affected by the Covid-19, 2020 available at https://productivitysa.co.za/blog/turnaround-strategies-for-businesses-affected-by-covid-19/ accessed on 29/08/2023.

[166] Ibid.

[167] Rajendra Rajaram op cit note 111 at 27.

[168] *Richter v ABSA Bank Ltd* 2015 (5) SA 57 (SCA).

[169] Ibid para 9.

The next requirement that was dealt with in this chapter is that of financial distress. Chapter three supports the notion that this requirement acts as a trigger for business rescue proceedings. No company can go under business rescue unless it is financially distressed. Contrary to the restrictive purpose discussed above, this chapter also discusses the fact that, unlike under judicial management, it is not a requirement that the company be in a dire or critical financial position for it to qualify for business rescue. The requirement of financial distress under business rescue sets a lower threshold which increases the chance of a company to be rescued unlike under judicial management where a company that is already in a critical condition would seek rescue. Furthermore, chapter three also discussed the two limbs of financial distress, namely commercial insolvency and insolvency in the balance sheet sense. The chapter also discussed the three courses of action that can be taken by a company in distress such as business rescue, turnaround, and liquidation. The following chapter on the other hand, will be focused on the requirement of a reasonable prospect. Chapter four will investigate if the requirement of a reasonable prospect has been successful in ensuring that the objectives that the process of business rescue was introduced for are being met.

CHAPTER FOUR

A CRITICAL ANALYSIS OF THE REQUIREMENT OF 'A REASONABLE PROSPECT'

I) INTRODUCTION

The second main requirement for the commencement of business rescue proceedings in South Africa is a reasonable prospect that a company in distress can be rescued. The expression 'reasonable prospect' appears several times in chapter six of the 2008 Companies Act. There are two contexts that are the most relevant in respect of this chapter.[170] The first context appears in sections 124 and 130 of the 2008 Companies Act which provides the statutory provision for the commencement of business rescue through its institution by a company resolution. The second context is in section 131 of the Act where it refers to a situation where business rescue is instituted through a court order.

The requirement of a reasonable prospect of rescue has received negative criticism from various academic scholars from its inception. These criticisms were, for instance, due to the fact that scholars were initially skeptical as to whether the requirement would suffice[171] in ensuring that the objective to facilitate the effective rescue and recovery of financially distressed companies, in a way that balances consideration of the rights and interests of all pertinent stakeholders[172] would be achieved. Further complicating the situation is that the 2008 Companies Act fails to provide a precise definition of this requirement. Consequently, the concept of a reasonable prospect can be interpreted through various lenses. O'Brien and Calitz held the view that the expression of a reasonable prospect could be paralleled to the test used in delict to determine negligence, which is the 'reasonable foreseeability' test.[173] These scholars drew a parallel between a reasonable person in delict and a reasonable business person in business rescue. This test is an objective one,[174] meaning that it strives to ascertain if there are grounds for a reasonable business person to conclude that business rescue proceedings may achieve one of the two goals of business rescue?[175]

The aim of this chapter is to assess whether this requirement of business rescue has been successful in ensuring that the objectives that the process for which business rescue was

[170] Patrick O'Brien and Juanitta Calitz 'A reasonable prospect for rescuing a company as a requirement for business rescue: a decade later' 2021 (4) *Journal of South African law 689.*
[171] Ibid.
[172] Section 7 (k) of the Companies Act 71 of 2008.
[173] Patrick O'Brien and Juanitta op cit note 170 at 696.
[174] Ibid.
[175] Ibid.

introduced are being met. To assess this, the chapter will start off by providing a brief historical background of the transition from 'reasonable possibility' to 'reasonable probability'. The former being a key requirement for the previous rescue mechanism and the latter being the requirement of the present rescue mechanism of business rescue. Thereafter, this chapter will explore the various interpretations of the requirement of a reasonable prospect of rescue in light of various cases, specifically those where business rescue was not permitted. This chapter does not purport to have the status of guidelines[176] for this requirement. The discussions on the decisions made by courts in this chapter are simply indications of how the requirement of a reasonable prospect may be interpreted.[177]

II) HISTORICAL DEVELOPMENT OF THE CONCEPT OF A REASONABLE PROSPECT

As pointed out in the first chapter of this dissertation, the rescue mechanism that existed prior to the implementation of business rescue was that of judicial management. It is unfortunate that this rescue process had a higher standard of proof that was required for its commencement which was a reasonable probability of recovery.[178] This standard was contained in section 427 of the 1973 Companies Act and according to this statutory provision the application for the previous rescue mechanism could be applied by the courts if certain grounds were met. These grounds included that it had to appear as just and equitable as a consequence of mismanagement or other causes that the company was incapable of meeting its debt payments, that the company had not achieved success or was hindered from attaining success and that it was reasonably probable that the company would benefit from the judicial management process that would enable it to settle its debts, fulfil its obligations, or thrive as a successful enterprise.[179] It is unfortunate, however, that there were some uncertainties regarding the meaning of this requirement of a reasonable probability.

The next point of discussion is the removal of the standard of a reasonable probability from the 2008 Companies Act and the reasons behind it. Regarding this, Burdette and Kloppers[180] have provided their criticisms which serves as evidence as to why this standard was replaced by the requirement of a, 'reasonable prospect'. This standard was criticized for

[176] Patrick O'Brien and Juanitta Calitz 'Considerations that inform the view of whether there us a reasonable prospect of rescuing a company: a decade of legal precedent' 2022 (1) *Journal of South African Law* 26.
[177] Ibid.
[178] EP Joubert op cit note 11 at 551.
[179] Section 427 of the 1973 Companies Act.
[180] Pieter Kloppers 'judicial management reform-Steps to initiate a business rescue' 2001 (13) *SA Mercantile Law Journal* 363.

its lack of effectiveness to the rescue mechanism of judicial management. In addition to this Klopper also criticized this standard for no longer being up to date[181] which can be interpreted to mean that it had become irrelevant. Hence it had to be replaced with the requirement of 'reasonable prospect' in the 2008 Companies Act. One example of a case that makes a comparison of the previous standard for the rescuing of a business to that of the present standard is *Noordkaap Lewndhawe Ko-operasi Bpk v Schreuder*[182] where Van Blerk AJ held that 'the difference between the words probable and possible is material.'[183] In this case, the court asserted that events described as 'possible' were deemed to be less likely to occur than those characterized as 'probable.'[184]

III) THE REQUIREMENT OF A REASONABLE PROPSECT

It is unfortunate that the failure to provide key definitions as was the case under the 1926 and 1973 Acts which failed to define the requirement of a reasonable probability is still present even under the 2008 Companies Act. As pointed out in the introduction, the current Companies Act does not furnish a definition for the essential criterion of a 'reasonable prospect of recovery.' The irony in this flaw is that this requirement is an essential element needed in the institution of a business rescue application.[185] The fulfilment of the requirement of a reasonable prospect is considered met when there are genuine possibilities of either restoring the company to solvency or at a minimum, negotiating a more favourable arrangement for creditors and shareholders than what they would receive through liquidation.[186] These preliminary conditions for this requirement of a 'reasonable prospect' align with one of the purposes of business rescue according to section 7(k) of the Companies Act which as alluded to in chapter two of this research is the provision of an efficient rescue and recovery of financially distressed companies in a manner that balances stakeholders' rights and interests. It can be argued that the primary objective of this requirement is for the company to be able to return to trade on a

[181] Ibid.
[182] *Noordkaap Lewendhawe Ko-operasie Bpk v Schreuder* 1974 3 SA 102 (A).
[183] EP Joubert op cit note 11 at 552.
[184] Ibid.
[185] Ngwenya Pervia Kudakwenyu, *A critical analysis of the business rescue requirements according to Newcity Group v Allan David Pellow and section 131(4) of the Companies Act of 2008* (LLM thesis University of Johannesburg, 2016) 17.
[186] Akhona Boloko and Shawn Barnett, 10 things to know about business rescue 2020 available at *https://www.financialinstitutionslegalsnapshot.com/2020/04/10-things-to-know-about-business-rescue/* accessed on the 29th of September 2023.

sound financial footing and also offer a better return for the company's shareholders than what would be available upon liquidation.[187]

It has been pointed out in the introduction that the phrase 'reasonable prospect' appears several times in the 2008 Companies Act. The relevant instances to this research where this phrase appears is in reference to what Joubert described as the dual gateways for the commencement of business rescue.[188] The first gateway that can be utilised for the commencement of business rescue is that which is often described as the 'voluntary route' this route is contained in section 129 (1) of the 2008 Companies Act. Under the voluntary route, the company directors can voluntarily place a company under business rescue if it can be proven that there are reasonable grounds that the company is financially struggling and that there is a reasonable prospect of the company getting rescued.

In *Koen v Wedgewood Village Golf and County Estate (Pty) Ltd*,[189] the court refused to grant an order in an application to place a company under business rescue because the applicant had not shown that there was a reasonable prospect of rescue. Joubert is of the opinion that the court held two contradicting positions in this case. In the first instance, reference to the requirement of a reasonable prospect was dependent on the objectives of the business rescue,[190] that is, if it aimed to either rescue the company in order for it to continue operating on a solvent basis or if its aim was to get better returns for creditors than they would get if the company was to be liquidated.[191] In respect of this, Binns J expressed that it was the job of the business rescue practitioner to point out whether there was a reasonable prospect for either of the objectives pointed out above to be met. The second position that was held by the court was in reference to the nature of the information brought before the court and it was held that for the business rescue application to succeed, the applicant must be able to place before the court a cogent, evidential foundation to support the existence of a reasonable prospect that the desired object can be achieved.[192] Binns J and Eloff AJ concurred in respect of this position and held that the nature of the information used to indicate the existence of presence of a reasonable prospect should not be vague but rather it should go beyond mere speculation.[193]

[187] EP Joubert op cit note 11 at 554.
[188] Ibid at 553.
[189] *Koen v Wedgewood Village Golf & Country Estate (Pty) Ltd* 2013 (1) SA 191 (WCC).
[190] Ibid para 17.
[191] EP Joubert op cit note 11 at 558.
[192] *Koen* supra note 189.
[193] EP Joubert op cit note 11 at 558.

IV) ANALYSIS OF CASE LAW

a) Swart v Beagles Run Investments 25 (Pty) Ltd[194]

This case was one of the first cases that dealt with the concept of business rescue after its inception into the South African legal system. In this case, the company lacked cash flow to pay its maturing debts as they became due and payable.[195] The court held that a reasonable prospect of the company getting rescued did not exist[196] because there were no indications to the court that the money owed to the creditors could possibly be repaid. Another factor that the court considered in reaching its decision was that the company Beagles Run Investments did not have enough assets that were sufficient to cover the debts.[197] In addition to this, the business rescue application failed because it was being pursued as a way to escape and to defer the payments of its debts. The main issue that the court dealt with was whether the second requirement of business rescue was genuinely present, or whether business rescue was being pursued as a means to frustrate creditors from enforcing their claims?

The question that therefore arises or that can be employed as pointed out in the introduction is, 'whether there exists a basis upon which a reasonable business person would be satisfied that a rescue process would achieve any of the goals of business rescue?' If the answer is in the negative, business rescue would not be an appropriate remedy.

Joubert criticises the fact that the court reached its decision by referring to section 427 of the 1973 Act which is problematic because the phrase 'successful concern' does not feature in the 2008 Companies Act.[198] In addition to this, Joubert argues that the aim of the new rescue mechanism was not limited to the sustained existence of a company, or a business. The other objective of this rescue mechanism is to acquire an improved arrangement or returns for the creditors, and it is unfortunate that the court did not consider this purpose when the matter was heard.

In addition to the criticism above business rescue is prone to abuse due to the fact that it makes it possible for affected businesses to commence business rescue proceedings with ulterior motives other than the motives that are aimed at rescuing the company, but as a means of frustrating creditors' endeavours to assert their rights against the company.[199] The abuse of

[194] *Swart v Beagles Run Investments 252.23.12-p-0 (Pty) Ltd* 2011 5 SA 422 (GNP).
[195] Ibid para 10.
[196] Ibid para 42.
[197] Ibid para 33.
[198] EP Joubert op cit note 11 at 555.
[199] Patrick O'Brien and Juanita Calitz op cit note 170 at 28.

the business rescue process is made possible by a moratorium[200] that is given to a company upon the commencement of the rescue process.

Barring any criticism about the fact that the court factored in whether the business could recover as a going concern which requirement is not part of 2008 Companies Act, it is arguable that the court was correct in refusing to grant an order that would have been used for the ulterior purpose of frustrating creditors' claims. This second requirement of business rescue is essential in protecting creditors' interests because if there was no reasonable prospect of recovery, then the business rescue process will be in vain.

Another important fact from this case is that the court was unhesitant to apply the generally established legal principles of, 'law to instances where attempts were made to use business rescue proceedings improperly to frustrate creditors.'[201] This is evidenced by the fact that the court employed terms from the previous Act and applied them in this case to reach its judgement. The role of the second requirement of business rescue is thus evident in this case for the court would not have been as critical in this case had it not been for questioning if there was a reasonable prospect of the company getting rescued or if rescue was being pursued as a means to frustrate creditors.

b) Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd[202]

In this case, Midnight Storm Pty Ltd was part of Realcor Group of companies and was indebted to Zoneska investments, for over half a million Rands[203]. Southern Palace Investments Pty Ltd was determined to the rescue of Midnight Storm Investments, and it sought to do this by working on forging new deals with all the relevant stakeholders.[204] There was, however, a challenge with the proposed rescue plan as it was dependent upon the cooperation between all the entities within the group. The challenge with the rescue plan was that it was not clear how it would assist in the granting of or the commencement of the rescue mechanism in respect of section 131 (4) of the Act.[205]

In discussing the requirement of a reasonable prospect, the court compared this requirement to the previous requirement of reasonable probability and held that the standard

[200] Section 133 of the Companies Act 71 of 2008.
[201] Patrick O'Brien and Juanitta Calitz op cit note 170 at 29.
[202] *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pt) Ltd* (15155/2011) [2011] ZAWCHC 442; 2012 (2) SA 423 (WCC) (25 November 2011).
[203] Ibid para 5.
[204] Ibid para 17.
[205] Ibid para 18.

under the 2008 Companies Act required less in comparison to the previous standard of reasonable probability.[206] The court held that there was no reasonable prospect of the respondent's business to be recovered or to be restored to a successful one because the proposed business rescue plan was not sustainable as it was unlikely to achieve anything feasible other than to protract distress by exchanging one obligation for a different one without any glimmer of hope or a foreseeable resolution.[207] O'Brien and Calitz were of the opinion that in determining whether there is a reasonable prospect the court in *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* assessed the proposed remedy to address the company's problems and whether the remedy was sustainable.[208]

Some of the factors that assisted the court to reach its decision include the fact that there was no concrete plan that had been produced that was to be used to resuscitate the company. In addition to this was the fact that one of the entities relied upon, Mr. Hasim, had previously been unsuccessful in instituting rescue. The court hence expressed the view that there was no reason to believe that another opportunity had the prospects of success or that there was a reasonable prospect of success.

The court also expressed the difficulty associated with granting business rescue in this case considering that the cause of the company's failure had not been addressed by those seeking business rescue.[209] Furthermore, the court expressed that irrespective of the fact that cases are judged on a case-by-case basis, parties are expected to provide more details that go beyond speculations. A similar reasoning was expressed in Koen *v Wedgewood*,[210] as well as in *Prospec Investments v Pacific Coast Investments*,[211] and *Oakdene Square Properties v Farm Bothasfontein*[212] where these courts pointed that in order to satisfy the requirement in question one has to make provision of information that is 'factual, objective, ascertainable and concrete.'[213] In the case under discussion, the court was not provided with enough evidence to show that there was a reasonable prospect which led the court to dismiss the application for business rescue and place the company under provisional winding up.

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[206] Ibid para 21.
[207] Ibid para 24.
[208] Patrick O'brien and Juanitta Calitz op cit note 170 at 30.
[209] Ibid para 24.
[210] *Koen* supra note 189.
[211] *Prospect Investments (Pty) Ltd v Pacific Coast Investments* 2013 (1) SA 542 (FB) para 12.
[212] *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others* 2013 (4) SA 539 (SCA).
[213] Mariam Ismail *'A critical discussion of the requirements of business rescue in terms of the Companies Act 71 of 2008'* (LLM Thesis UKZN, 2020) at 46.

Joubert expresses that this case is one of the most important cases when it comes to business rescue due to the fact that it is one of the earliest cases that dealt with the concept of business rescue.[214] This scholar criticizes the approach that was taken by the court in this case because the formulation that was adopted by the court in considering the restoration of the company to a successful one was flawed due to the fact that it arose under the old rescue mechanism[215] and not under the new rescue mechanism. Another criticism is that the checklist that the court relied upon in making its decision whether to grant business rescue required information that would not often be available when the application is instituted.[216] Joubert argues that the court placed the standard of a reasonable prospect high.[217]

c) Nedbank Ltd v Bestvest 153 (Pty) Ltd[218]

The respondent in this case owned an incomplete building that had been financed by funds from its creditors, Imperial Bank limited and Structural Mezzanine Investments. It was not in dispute in this case that the company was in financial distress but the requirement that was in question was that of reasonable prospect. The court expressed its support for the approach that had been suggested in the *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pt) Ltd* and *Swart v Beagles Run Investments 25 (Pty) Ltd* where it was held that the standard test for successfully granting a business rescue application was not as onerous as under judicial management.[219]

The court in this case also expressed that the interpretation of the requirement of a reasonable prospect was to be accompanied with sufficient evidence that would be used in persuading a court to grant the business rescue application. The court also held that, that in trying to give effect to the purpose of section 131 of the 2008 Companies Act, a court should not set the bar too high in such a way that the applicant for business rescue will struggle to persuade the court to grant the business rescue application.[220] In respect of the information that must be contained in the application, the court held that the business rescue applications should contain a summary of the proposed business rescue plan.[221] The business rescue plan should be reserved for business rescue practitioners since they have the opportunity to establish full

[214] EP Joubert op cit note 11 at 556.
[215] *Southern Palace* Supra note 20 para 23.
[216] EP Joubert op cit note 11 at 557.
[217] Ibid.
[218] *Nedbank Ltd v Bestvest 153 (Pty) Ltd supra-Essa and Another v Bestvest and Another* ZAWCHC 139; 2012 (5) SA 497 (WCC); [2012] 4 All SA 103 (WCC) (12 June 2012).
[219] Ibid para 27.
[220] Ibid para 38.
[221] Ibid para 40.

details once they have the opportunity to make a proper assessment of the company.[222] However, a company cannot make its business rescue application making use of flimsy grounds in hopes that the practitioner will provide a panacea to its problems.[223] The court requires enough information to make an assessment of the reasonable prospect in order to grant business rescue proceedings.[224]

Unfortunately, the court in this case was not persuaded that there was any reasonable prospect that the company could be rescued. There was not enough information to demonstrate a plausible likelihood of raising any further loans that could ensure the recovery of the company.

d) FirstRand Bank Limited v Normandie Restaurants Investments and Another[225]

In this matter, FirstRand Bank Limited made an application to wind up the respondent and Normandie Restaurants Investments made a business rescue application. Normandie Restaurant investments believed it had a plausible chance of being rescued from distress because of the rental it was to receive from a tenant.[226] First Rand Bank argued otherwise and was of the opinion that Normandie Investments could not be rescued and that there was no reasonable prospect of the company getting rescued because the rental income from the tenant was inadequate to settle Normandie's indebtedness.[227]

The court found that there was no reasonable prospect that the company was to be rescued and dismissed the application. It ordered that the company was to be placed under final winding up with costs.[228] The court had discovered that the rescue plan was completely reliant on the relationship between the company and its tenant, a relationship which would fall away on the expiry of the lease.[229] Furthermore the court's findings were that the rescue plan that had been proposed was significantly lacking the required information in terms of section 150 (2) and (3) of the 2008 Act.[230]

It can be argued that in making a determination on the reasonable prospect in this case, the court made a value judgement. Cassim criticizes this by expressing that it was done without

[222] Ibid.
[223] Ibid para 41.
[224] *Koen* supra note 189.
[225] *FirstRand Bank v Normandie Restaurants Investments and Another* 189/2016 [2016] ZASCA 178.
[226] Ibid para 5.
[227] Ibid para 6.
[228] Ibid para 28.
[229] Ibid para 25.
[230] Ibid.

the exercise of discretion.[231] Based on the findings of this case, it is evident that court required more than just mere suggestions, but that the prospects in question had to be based on reasonable grounds. It also bears mention that the interests of the creditors in this case were considered.[232]

V) CONCLUSION

In conclusion this chapter identified a few considerations of the requirement of a reasonable prospect. The nature of information contained in an application for business rescue must go beyond mere speculation. There is no universal application of the determination of the requirement of a reasonable prospect as this requirement is assessed on an individual basis depending on the circumstances or the facts that would have been presented before the court. Based on the cases that have been dealt with in this chapter, it is evident that the second main requirement for business rescue, namely that the company has reasonable prospects of recovery, plays an integral role in ensuring that the rescue mechanism operates effectively. This requirement ensures that companies that have no reasonable prospect of getting rescued do not go under business rescue. However, it is very important to reemphasis the fact that this chapter did not seek to layout the status guidelines of the requirements of business rescue. As pointed out before in this chapter the cases that have been discussed herein simply serve the purpose of showing indications on how this requirement can and have been interpreted. The next chapter is the final chapter of this research. This chapter will conclude this research and make some recommendations.

[231] Cassim et al op cit note 5 at 1209.
[232] Ibid.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

In summation, this research unpacked business rescue's development and discussed its key requirements. Unlike its predecessor, judicial management which was creditor-centric, the concept of business rescue is debtor-centric. Business rescue strives for the continued existence of a business or company provided it satisfies the statutory requirements which have been discussed herein.[233] This concept of business rescue is one of the three courses of action at the disposal of financially distressed companies. The other two options are a turnaround and liquidation. Turnaround can be described as a recovery of an organization's economic performance following an existence-threatening decline.[234] Liquidation is the worst of the three because it has the potential to diversly impact both the microscale and the macroscale negatively.[235] On a microscale, liquidation has the potential to negatively affect individual companies, shareholders and company stakeholders such as the employees, whereas, on a macroscale, it has the potential to negatively affect a nation's economy at large.[236] Business rescue on the other hand has the potential to positively impact entities either on a microscale as well or on a macroscale. This is the reason why it has been the preferred method since its inception as evidenced by the steady increase of companies going under this process.

There are a number of factors that have been identified in this research as contributing to the adoption of this new rescue mechanism into South African corporate law. Some of these factors include the fact that the process of judicial management was ineffective and had lost its relevance.[237] Other factors include that the adoption of the current business rescue procedures was long overdue in South Africa as evidenced by the fact that other big economies such as the United Kingdom and Australia had already adopted a similar rescue mechanism.[238]

The main purpose of business rescue is contained in section 7(k) of the 2008 Companies Act. Its purpose is to provide an efficient rescue mechanism that balances the rights and the interests of all the stakeholders.[239] As highlighted above, this purpose is a manifestation of one

[233] Cassim et al op cit note 5 at 1184.
[234] Balgobin, R. & Pandit, N 'Stages in the Turnaround Process: The Case of IBM UK' (2001) 19(3) *European Management Journal* 301.
[235] Loubser op cit note 9 at 138.
[236] Cassim et al op cit note 5 at 1182.
[237] *Le Roux Hotel Management* supra note 31.
[238] Cassim op cit note 5 at 1185.
[239] Section 7(k) of the 2008 Companies Act.

of the objectives that the Department of Trade and Industry had when the 2008 Companies Act was being drafted, namely the creation of a legal system that provides a protective and fertile environment for economic activity.[240]

It has been noted that the requirements of business rescue are far from perfect. However, the requirements assist to ensure that the business rescue process is conducted in an efficient manner and produces the intended results to a greater extent. The evidence in the effectiveness of business rescue requirements can be seen in the steady rise of companies that are willing to subject themselves to the process and the steady increase of those getting rescued. It is worth pointing out that regardless of the steady increase in the overall number of companies going under business rescue, this rescue mechanism has previously been characterised with a low success rate which has been a subject of criticism.

The purpose of the requirements of business rescue is that they act as standards for companies that can potentially be placed under business rescue. The three requirements for business rescue discussed in this dissertation are that the entity in question must be a company as defined in the 2008 Companies Act, the company must be financially distressed and there must be reasonable prospect that the company will recover. These requirements have their limitations for example, the Act does not define what 'reasonable prospect' means. Consequently, this requirement has no fixed definition, and it is assessed on an individual basis depending on the circumstances or the facts of each case.

The other requirement that was discussed herein is the requirement that a company must be a company as defined by the 2008 Companies Act. It can be argued that this requirement is a minor requirement because it is often not discussed. The principal case that dealt with this requirement is *Cooperativa Muratori & Cementitsi v Companies and Intellectual Property Commission (CMC).*[241] This requirement excludes foreign companies from benefiting from the remedy that is business rescue.[242] This is a huge shift from the position that existed under the Companies Act 61 of 1973. This exclusion stifles out the innovation that business rescue intended to protect. It can thus be recommended that the 2008 Companies Act should be amended to extend the remedy to foreign companies so that they can also undergo business rescue where circumstances permit.

[240] Government Gazette op cite note 36 at 11.
[241] *Cooperativa Muratori & Cementitsi* supra note 25.
[242] Iram Hayath op cit note 103 at 67.

Regarding the requirement of the financial distress, chapter three of this dissertation points out how this requirement has transformed corporate rescue because, unlike under judicial management where for a company to be regarded as being in a state of financial distress that company was required to be already unable to pays its debts. Under the 2008 Companies Act a company does not have to be in a dire position for it to qualify as being financially distressed. The standard of financial distress under business rescue is lower and it assists the process of business rescue by increasing the probability of a company to get rescued, unlike under judicial management where the chances of a company that is already unable to pay its debts might be challenging to resuscitate. The standard of financial distress under the 2008 Companies Act improves the prospect of a company to get rescued. This dissertation supports the position that was held by the KPMG auditors but was rejected by the portfolio committee. As discussed in this research these auditors submitted that there should be an increase of the six-month period contained in the financial distress test to twelve months.[243] The dissertation reproposes and recommends the submission that was made by the KPMG auditors due to the fact that the six-month period is short and increasing the time period for the test provides a financially distressed company with ample time to take the necessary measures that will protect it.[244] This can potentially assist in increasing the success rate of business rescue in South Africa.

In essence, in as much as the requirements of business rescue are not perfect there is need for these requirements to constantly evolve in order for businesses to fully capitalize on this concept of business rescue. However, it is quite evident that these requirements have been playing a very important role in ensuring that the process of business rescue delivers what it was intended to deliver when it was still being drafted.

[243] Anneli Loubser op cit note 129 at 58.
[244] Ibid.

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Mr Tafadzwa Munashe Chikuvanyanga (219043506)
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Pietermaritzburg

Dear Mr Tafadzwa Munashe Chikuvanyanga,

Original application number: 00021787
Project title: A critical analysis of the requirements needed for the commencement of business rescue in South Africa.

Exemption from Ethics Review

In response to your application received on 20 June 2023 , your school has indicated that the protocol has been granted **EXEMPTION FROM ETHICS REVIEW.**

Any alteration/s to the exempted research protocol, e.g., Title of the Project, Location of the Study, Research Approach and Methods must be reviewed and approved through an amendment/modification prior to its implementation. The original exemption number must be cited.

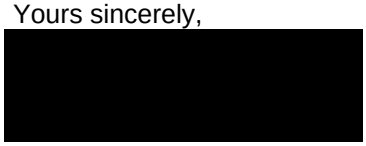
For any changes that could result in potential risk, an ethics application including the proposed amendments must be submitted to the relevant UKZN Research Ethics Committee. The original exemption number must be cited.

In case you have further queries, please quote the above reference number.

PLEASE NOTE:
Research data should be securely stored in the discipline/department for a period of 5 years.

I take this opportunity of wishing you everything of the best with your study.

Yours sincerely,



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