UNIVERSITY OF KWAZULU-NATAL

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A critical analysis of the institution of Business Rescue Proceedings during Liquidation Proceedings

Sanam Krishundutt

211503736

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Supervisor: SP Phungula

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DEDICATION

I dedicate this work to my parents, Mr and Mrs Krishundutt, who have, throughout my studies, supported, loved and encouraged me to achieve everything that I have desired. Everything that I am today and everything that I will ever be is because of them.

ABSTRACT

South Africa is currently undergoing harsh economic times, and as such, many companies are feeling the brunt of the situation. As a result, these companies begin to trade at a loss and are left without any other option but to liquidate their affairs in order to pay off creditors. However, with the development brought by the Companies Act 71 of 2008 ("the Act"), business rescue was introduced. Business rescue is an alternative to liquidation and it allows the company to undergo rehabilitation and continue trading if certain requirements are met.

Chapter 6 of the Act aims to assist businesses in providing some sort of relief in the form of business rescue to provide them with the breathing space that they require to try and become a viable business again.

Just like any new formulated concept, it is susceptible to abuse. Many companies that are already under liquidation are suspending their liquidation in favour of business rescue, despite, in some instances, the liquidation order having already been granted against the company.

The Covid-19 pandemic has made the question of whether a business can suspend liquidation proceedings in favour of business rescue more prevalent as the pandemic has caused a detrimental financial impact on a number of businesses. Now more than ever businesses find themselves struggling to keep afloat, and as a result many of them have to consider the avenues of liquidation or business rescue.

This dissertation aims to look at both liquidation and business rescue proceedings and decipher whether the courts were correct in their decision regarding when business rescue proceedings can be instituted during liquidation proceedings.

The importance of taking into account the above is due to the fact that many companies in present day are experiencing financial difficulties, and liquidation or business rescue proceedings are the options that they are left with. However, one has to carefully consider both options, taking into account the company's financial circumstances. This is of importance, as one needs to establish if there is a reasonable prospect of rescuing the company or not. If there were, then business rescue would indeed be the route to be taken, but if not, then liquidation proceedings would be. However, many companies that have no prospect of being rescued, and that have already opted for liquidation may

want to institute business rescue proceedings to delay the inevitable and frustrate creditors, thus leading to the abuse of the newly formulated concept, which has to be curbed.

TABLE OF CONTENTS

1 INTRODUCTION

1.1 Introduction

In the tough economic times that South Africa is facing, it is important to take note of how essential it is to nurture and enhance the growth of companies, whose importance is underlined by the contribution that they make to our economy by creating jobs, paying millions of Rand in taxes and assisting in the creation of innovations with great potential.[1] It then becomes rather obvious as to the ripple effect that is caused when these companies shut their doors, with the catastrophic effect that it will have, not only on the economy, but also on creditors, employees and the community at large.[2]

It is with the above reasoning that the legislature sought to avoid the aforementioned consequences with the introduction of the concept of business rescue in the Act. Business rescue is defined as "*proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for— (i) the temporary supervision of the company, and of the management of its affairs, business and property; (ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and (iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company*"[3]. While trying to rescue the company, this must be done in a way that takes into account the rights and interests of all relevant parties.[4] By definition, business rescue includes a "better return for creditors." This means that this is the best option for creditors, compared to immediate liquidation, since they gain a better return on their investment.[5]

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[1] Ndlovu N and Makgetla N 'The State of South African Small Business' in 2017 *The Real Economy Bulletin 3* (2017).

[2] Cassim, M.F. ...et al. *Contemporary Company Law* ed Cape Town: Juta (2011) 862.

[3] Section 128(1)(b).

[4] Section 7 (k).

[5] Loubser A *Some Comparative Aspects of Corporate Rescue In South African Company Law* (LLD dissertation 2010 Unisa) 21. (LLD thesis UNISA, 2010, hereinafter `Loubser`) 447.

Furthermore, since the definition includes "rescuing a company", successfully rescuing a company saves jobs[6] as opposed to liquidation wherein thousands are left unemployed. Additionally, business rescue does not carry the same stigma as liquidation.[7]

A number of ailing companies have tested the introduction of the Act in 2011. Since the introduction of Act, the number of companies filing for liquidation has decreased. For example, 1 962 companies were liquidated in 2015.[8] This number slightly decreased in 2016.[9] This decrease became vivid again in 2017, where by the end of February 2017, the number of companies filing for liquidation decreased by 24.4% than the number of companies that filed for liquidation at the end of February 2016.[10] A further 9.6% reduction was seen in the total number of liquidations recorded between March 2018 and March 2019.[11] These statistics show a shift from a liquidation culture to companies' beginning to rely more on business rescue.[12]

1.2 History of South African Business Rescue Mechanism

Business rescue culture in South Africa is not completely new as it started in 1926 with the paper46 of 1926 (hereinafter "the 1926 Act"). Traditionally, South Africa relied on liquidation proceedings as a solution when companies found themselves in financial distress. However, with South Africa being a developing country, it came to the realisation that it cannot afford to have companies that contribute to the economy shut their doors.[13] With that in mind, South Africa adopted the concept of rescuing ailing

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[6] Loubser, 450.

[7] Loubser, 452.

8 'Statistics of liquidations and insolvencies (Preliminary)' available at *http://www.statssa.gov.za/publications/P0043/P0043September2016.pdf*, accessed on 14 October 2017.

[9] 'Statistics of liquidations and insolvencies (preliminary)' available at *http://www.statssa.gov.za/publications/P0043/P0043February2017.pdf*, accessed on 25 March 2017.

[10] Ibid.

[11] 'Statistics of liquidations and insolvencies (preliminary)' available at *http://www.statssa.gov.za/publications/P0043/P0043March2019.pdf*, accessed on 8 February 2021.

[12] 'An explorative view of business rescue practitioner in SA', available at *http://mailimages.vibrantmedia.co.za/2016/unisa/meditaripapers/Patel.pdf*, accessed on 5 April 2017.

[13] Cilliers HS and Benade ML et al. *Corporate Law* (2000) 478.

companies.[14] Under the 1926 Act, the rescue mechanism was known as judicial management. Judicial management was aimed at rescuing financially distressed companies. South Africa was one of the early adopters of this rescue mechanism since its introduction in the early 1920s.[15]

Although judicial management came to rescue ailing companies, it came with its own problems. Since it was a new mechanism, a lot had to be done so that it became a viable mechanism.

If the company was in a financial quagmire, and there were reasonable prospects that judicial management would overturn their shortcomings, then the court would grant such an order (judicial management) in the hope that the company would revive itself.[16] Despite South Africa being one of the early adopters of judicial management, it failed to develop it in line with other modern insolvency systems.[17] This is evidenced by the fact that judicial management did not undergo significant amendments since its introduction into the 1926 Act, save to state for the provision regarding the *moratorium* on claims by creditors which was introduced in s52 of the Companies Act 23 of 1939.[18] Thereafter, it was merely duplicated in the Companies Act 61 of 1973 (hereinafter "the

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[14] Burdette DA 'Some initial thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 1)' (2004) 16(2), *South African Mercantile Law Journal* (hereinafter `Burdette`) 246.

[15] Loubser A 'Business Rescue in South Africa: A Procedure in Search for Home' (2007) 40(1) *Comparative and International Law Journal of Southern Africa* 153. Joubert EP '"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* 551. See also *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd* 2001 (2) SA 727 (C) at para 37 when Josman J held that when judicial management was introduced as a business rescue mechanism in South Africa by the Companies Act 46 of 1926, it was not based on any English Companies Act but was a "usual source of inspiration for matters relating to companies".

[16] Section 427(1) of the Companies Act 61 of 1973.

[17] ibid

[18] Olver H 'Judicial Management - A case for Law Reform' (1986) 84 *Tydskrif vir Hedendaags Romeins-Hallandse Reg*.

1973 Act"),[19] due to the fact that the procedure had previous success according to the Millin Commission.[20]

After the introduction of the 1973 Act – judicial management continued to receive criticisms. Commentators criticized judicial management and referred to it as a failure[21] as it was unable to meet its goals. After coming into force in the 1973 Act, more criticisms followed. These criticisms included, amongst others, that:

- There was a general reluctance in proceeding by way of judicial management, given the fact that the burden of proof placed on the company was too onerous to provide that "the company had a reasonable probability of becoming a successful concern."[22]
- As a result of judicial management placing a heavy reliance on court proceedings, there would naturally be high legal costs associated with it, which to a company that is already in financial difficulty it would not make financial sense to proceed, when the company is already cash strapped.[23]
- The judicial management process requires the appointment of a liquidator to manage the affairs of the company. The problem with this is that the liquidators are in the business of liquidating companies and their assets, and not to make them financially viable.[24]

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[19] Sections 427 to 440 of the 1973 Act. Joubert EP '"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* (hereinafter 'Joubert') 552.

[20] Loubser A 'Judicial Management as a Business Rescue Procedure in South African Corporate Law' (2004) 16(2) *South Africa Mercantile Law Journal* 139.

[21] Loubser supra note 9 at 153. Joubert EP '"Reasonable possibility" versus "Reasonable prospect": Did business rescue succeed in creating a better test than judicial management?' (2013) *Journal of Contemporary Roman-Dutch Law* 76 at 551. Smits A 'Corporate Administration: A Proposed Model' (1999) *De Jure* 85. Loubser supra note 5 at 140.

[22] Burdette 249. Smith,A 'The major creditor's wishes usually prevail' (2001) 9 *Juta's Business Law* 145.

[23] Burdette 249. Kloppers, P 'Judicial Management Reform- Steps to initiate a Business Rescue' (2001) 13(3) *South Africa Mercantile Law Journal* 370.

[24] Burdette 250.

These flaws and criticisms thus showed that there was a need for a new system. The Act then came into force in 2011. The purpose of the introduction of business rescue was to defer away from that of a creditor approach in judicial management and enter into a more debtor friendly one in business rescue, as well as to avoid the inherent problems associated with judicial management.[25] This aim is emphasized in the purpose of the Act, which is articulated by section 7(k) which provides that one of the aims of the Act is to efficiently provide for the rescue and recovery of financially distressed companies, whilst ensuring that the rights and interests of the various stakeholders are taken into account. It is also specifically states in section 5(1) that the Act must be read and interpreted in a manner that gives effect to section 7.

The aim behind section 7(k) was to cure the failure of judicial management and its inefficiencies, as well as to provide for the rescue of a company whilst considering the interest of all affected persons.[26] The aforementioned aims are further encapsulated in the case of *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd*[27], where it was held that the thinking behind business rescue was to try and preserve a business and its employees, which could turn out to be a better option for a creditor to recoup his debt.

In addition, *DH Brothers Industries (Pty) Ltd v Gribnitz NO & others*[28] held that businesses are the lifeline of economies and provisions are aimed at assisting businesses to ensure the efficiencies of economies.

Taking into account the purpose and importance of business rescue above, it can be commenced by either resolution[29] or court order.[30] Section 129 (1) states that should there be reasonable grounds to believe that a company is financially distressed and that there are reasonable grounds of belief that the company can be rescued then a resolution

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[25] Klopper H and Bradstreet RS 'Averting Liquidations with Business Rescue: Does a section 155 Compromise place the bar too high?' (2014) 25 *Stellenbosch Law Review* 549.

[26] Mokoena *The Philosophy of Business Rescue Law* (Unpublished LLD thesis, University of Witswaterstrand 2019) at 3.

[27] 2012 (3) SA 273 (GSJ) 12.

[28] 2014 (1) SA 103 (KZP) 1.

[29] Section 129.

[30] Section 131.

may be adopted to place the company under voluntary business rescue and supervision. On the other hand, section 131 (1) states that should a company not have adopted a resolution as per section 129 above, then an affected person may make an application to place the company under business rescue.

However, as is with any new formulated concept, it is susceptible to abuse, and many companies that are in the liquidation process are suspending this process in favour of business rescue, despite, in some instances, the liquidation order having already been granted against the company in terms of section 79(b) or section 81 of the Companies Act.

The abuse that business rescue is suspectable to was evidenced in the recent case of *Standard Bank of South Africa Limited v C and E Engineering (Pty) Ltd and Others*[31], where the court was tasked with dealing on whether or not it should convert an already passed board resolution to place the company under business rescue into a liquidation order. The court took into account the facts on whether or not there was a reasonable prospect in rescuing the company, and it found that in fact the company was reliant on the finances provided by Standard Bank and without such post commencement finance the company would not be viable.[32] Given the fact that Standard Bank were not willing to extend further finances to the company, there existed no possibility of the company being rescued.[33] As can be noted in this case, there was blatant abuse of the business rescue provisions as the board of directors placed the company under business rescue knowing full well that there was no possibility of rescuing the company from the dire financial situation that it found itself in.

1.3 Problem Statement

Once business rescue proceedings are commenced with, there are consequences that are entailed, one being the suspension of liquidation proceedings.

Liquidation proceedings are suspended once business rescue is applied for. Section 131 (6) of the Act provides that should liquidation proceedings have commenced against the company then this will be suspended pending the outcome of the application for business rescue by the courts, or the end of the business rescue proceedings.

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[31] 2020 ZAGPJHC 255

[32] Ibid para 54.

[33] Ibid para 46.

This dissertation is based on the initiation of business rescue proceedings during liquidation proceedings, and whether or not the decisions taken by the courts to institute business rescue at any time during liquidation proceedings was correct. This dissertation aims to look at both liquidation and business rescue proceedings and decipher whether the courts were correct in their decision regarding when business rescue proceedings can commence during liquidation proceedings. The importance of taking into account the above is due to the fact that many companies in present day are experiencing financial difficulties, and liquidation or business rescue proceedings are the options that they are left with. However, one has to carefully consider both options, taking into account the company's financial circumstances. This is of importance, as one needs to establish if there are reasonable prospects of rescuing the company or not. If there were, then business rescue would indeed be the route to be taken, but if not, then liquidation proceedings would be. However, many companies which have no prospect of being rescued, and who have already opted for liquidation may want to institute business rescue proceedings to delay the inevitable and frustrate creditors, thus leading to the abuse of the newly formulated concept, which has to be curbed.

1.4 Issues to be Examined

This dissertation aims to critically analyse the institution of business rescue proceedings during liquidation proceedings.

As such, the following questions need to be explored.

1. What is liquidation proceeding and what are its requirements to be instituted?
2. What is business rescue and its process?
3. When do liquidation proceedings start and when do they end? and
4. Does business rescue have an effect on liquidation proceedings? If yes, what are the effects?

1.5 Research Methodology

This dissertation was a desktop study. The research was conducted using current legislation and case law, as well as literature in the form of academic journal articles.

1.6 Structure of the Dissertation

This dissertation will have chapters with subheadings.

Chapter 1: Introduction

This chapter introduces the research questions and gives a brief background into the research topic.

Chapter 2: Business Rescue Proceedings

This chapter looks at the initiation of business rescue proceedings and the requirements thereto.

Chapter 3: Consequences of Business Rescue Proceedings

This chapter gives a general background of the consequences of business rescue proceedings and the particular consequence of the suspension of liquidation proceedings by business rescue proceedings.

Chapter 4: Further Recommendations

This chapter will provide further recommendations on business rescue.

Chapter 5: Conclusion

This chapter will discuss the overall conclusion reached regarding the research topic.

2 BUSINESS RESCUE PROCEEDINGS

In this chapter the commencement of business rescue, by the board of directors ,will be explored, together with the requirements of business rescue taking into account the definitions of "financial distress" and "reasonable prospect". In addition, the commencement of business rescue by affected person will also be considered together with the definition of "just and equitable".

2.1 Commencement of Business Rescue Proceedings:

The timing of the commencement of business rescue is critical, as premature commencement may result in prejudicing creditors. On the other hand, a delay in commencement could be too little too late to rescue the company.[34]

The procedure required to commence business rescue proceedings is commenced in terms pf section 129(3) of the Act:

Within five business days after a company has adopted and filed a resolution, as contemplated in subsection (1), or such longer time as the Commission, on application by the company, may allow, the company must

a) *publish a notice of the resolution, and its effective date, in the prescribed manner to every affected person, including with the notice a sworn statement of the facts relevant to the grounds on which the board resolution was founded; and*
b) *appoint a business rescue practitioner who satisfies the requirements of section 138, and who has consented in writing to accept the appointment.*

The procedure related to a board of directors is very onerous and there appears to be strict timelines in place, without any due reasons being given. One could assume that the strict timelines are in place to ensure that there is speedy finalization of the matter, as time is of the essence. However, this then begs the question of why the same time

[34] Bradstreet R 'The new business rescue: Will creditors sink or swim?' 2011 *SALJ* 352 at pg.364. Hereinafter 'Bradstreet'.

limits are not imposed when an affected person brings an application for business rescue?

In addition, the board of directors are to resolve the resolution amongst themselves and there is not a procedure highlighted in the Act that requires them to consult with a third independent party, such as an accountant. The importance of this is that business rescue proceedings are commenced mainly due to financial difficulties, and as such, parties that are involved in the financial industry should be consulted to advise whether it is feasible to proceed with business rescue proceedings. This could also potentially assist the directors if there is an objection to the resolution, as they could use the advice of the accountant to further substantiate their reasoning behind adopting the resolution and would have a far better case than they would without the advice of the accountant.

It also important to highlight that section 22(1), amongst other things, places an obligation on directors to not trade recklessly. Consequently, this entails that a director would have a duty to pass a resolution to place the company under business or consider other winding up alternatives to ensure compliance with section 22(1) if the company finds itself in financial situation.

Alternatively, business rescue proceedings can be commenced by an application by an affected person in accordance with section 131 of the Act, wherein an affected person may apply to court to place a company under business rescue, provided that the company has not already resolved to be placed under business rescue in terms of section 129 of the Act.

The procedure to commence business rescue proceedings by an affected person is found in section 131 (3) of the Act which requires the affected person to serve a copy of the application on the company and the Commission, as well as to notify each affected person of the application.

As can be seen there is a vast difference in the procedure that a board of directors needs to meet as opposed to an affected person when wanting to institute business rescue proceedings.

In terms of the procedure pertaining to affected persons, section 128(1)(a) of the Act defines an affected person as being “a shareholder or creditor of the company, a

registered trade union, or employees or their representatives."[35] The interesting factor to note here is that affected persons do not include directors of the affected company. This essentially means that should a director want to place the company under business rescue, but the rest of the board of directors do not wish to do so then the director's powers are limited, and he has no further options available to him to proceed with the application. To preclude a director (who surely has a direct interest in the company) from bringing an application for business rescue on his own accord is surely limiting in terms of the legislation, especially in the case of where the board of directors are not acting in the company's best interest.

On the other hand, it could be argued that the preclusion of a director as an affected person is linked to the fact that the legislature may not have wanted to create an avenue for a director to undermine the board of directors, and the fact that they resolved not to pass the resolution to proceed with business rescue indicates that reasonable grounds lie in not wanting to proceed with business rescue.

2.2 Requirements for Business Rescue Proceedings

2.2.1 General Background on Section 129 and 131(4)

The requirements for business rescue that is initiated by a resolution by the board of directors is found in section 129(1) of the Act, and by application by affected person in section 131(1). Section 129 provides that, "should there exist reasonable grounds to believe that a company is financially distressed and that there are reasonable grounds of belief that the company can be rescued then a resolution may be adopted by the board of directors of the company to place the company under voluntary business rescue and supervision."[36] In turn section 131(1) provides that should a resolution have not been passed by the company to place it under business rescue in terms of section 129 of the Act, then an affected person may apply to place the company under business rescue and supervision.

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[35] Section 128(1)(a) of the Act.

[36] Section 129 of the Act.

Section 131(4) also provides that the court may place a company under business rescue proceedings should it be satisfied of the following:

- the company is financially distressed;
- the company has failed to pay over any amount in terms of an obligation under or in terms of a public regulation, or contract, with respect to employment-related matters; or
- it is otherwise just and equitable to do so for financial reasons, and there is a reasonable prospect for rescuing the company.

Before one is to deal with the requirements in terms of both section 129 and section 131 – it is important to comment on the requirements in general. As can be noted in the above, the threshold in proving that a company should be placed under business rescue by an affected person is far higher than it is for an application made by the board of directors.[37] The reason for this is that there appears to be only two requirements needed to be met by the board of directors to initiate business rescue, as opposed to an affected person who has to meet four requirements. It is not clear whether this was intended by the legislature or it was a mistake. In this regard, it is suggested in this dissertation that the Act be amended to assist affected persons in meeting these requirements.

2.2.2 Meaning of Financial Distress

As seen above, section 129(1) directs that business rescue can proceed if the board of directors have reasonable grounds to believe that:[38]

a) the company is financially distressed; and

b) there appears to be a reasonable prospect of rescuing the company.

As per the above section, the first requirement is to establish if a company is in financial distress.

It is important to highlight that 'financially distressed' refers to commercial insolvency, which refers to a company that has come to a point where it is unable to pay its debts

[37] *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* 2012 (2) SA 423 (WCC).

[38] Section 129(1)(a) and (b) of the Act.

as they become due.[39] Whereas, factual insolvency refers to insolvent company that can still pay of its debts.[40] In order to establish this, the requirements of section 128(1)(f) of the Act need to be met:

(i) it appears to be reasonably unlikely that the company will be able to pay all of its debts as they fall due and payable within the immediately ensuing six months; or

(ii) it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months.

Once a company establishes this, they have inadvertently completed the first test that is entailed in proving to be financially distressed, according to section 128(1)(f)(i) of the Act above.

The second test, found in section 128(1)(f)(ii) of the Act above, is the 'balance sheet' test, which evaluates the value of the assets of the company being lower than the amount of liabilities. However, the concern here is that there may be many uncertainties and variables to consider, whereas in the first test above it is clearer when it comes to establishing that a company cannot meet its liabilities.[41]

In addition, it has also been argued that financially distressed does not refer to current insolvency but future insolvency.[42] The reasoning behind this is sound in that if a company is presently insolvent then the court should be left in a position where it will have to issue a liquidation order, as it would appear that the company has surpassed the threshold of being "rescued".

It is important to note the difference between section 4, which deals with the solvency and liquidity test, and section 128(f) in that a company is considered to be financially

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[39] Wassman B 'Business rescue- getting it right' (2014) 538 *De Rebus* 36-37.

[40] Deloitte: The Companies Act, when is a company financially distressed, and what does it mean? *https://www2.deloitte.com/content/dam/Deloitte/za/Documents/governance-risk-compliance/ZA_FinancialDistress_15052014.pdf*, accessed 27 August 2019).

[41] Rushworth J 'A critical analysis of the business rescue regime in the Companies Act 71 of 2008' 2010 *Acta Juridica* at pg.377.

[42] *Firstrand Bank Ltd v Lodhi 5 Properties Investment CC* 2013 3 SA 212 (GNP).

distressed if it is either factually or commercial insolvent, while a company will be said to be solvent and liquid if it satisfies both factual and commercial solvency.

Once it has been established that a company is in financial distress and that there is a reasonable prospect of saving the company[43], then the board of the company can resolve to initiate of business rescue.

Though the question arises that inadvertently in order to prove that a company is in financial distress, one would have to shed light on its inability to pay debts that are due and provide evidential proof thereof. As such this requirement should be explicitly provided for in section 129(1) of the Act.

2.2.3 Meaning of Reasonable Prospect

In both the requirements for the board of directors and an affected person, there is the requirement that a "reasonable prospect for rescuing the company" exists. In this regard, it can be seen that although not expressly defined in the Act, it is imperative to prove that a reasonable prospect exists that business rescue will succeed, and not to prove that business rescue will necessarily succeed.[44] In terms of this, A.G. Binns-Ward held that *"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."*[45]

Further, reasonable prospect entails looking into the future in order to make an accurate predication of where the company would likely be in the ensuing years.[46]

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[43] Section 129(1) of the Act. See also *Nedbank Limited v Bestvest 153 (Pty) Ltd*; *Essa v Bestvest 153 (Pty) Ltd* 2012 5 SA 497 (WCC); *Anglo Irish Bank Corporation Ltd v West City Precinct Properties (Pty) Ltd* 2013 JDR 1895 (WCC); *Redpath Mining South Africa (Pty) Ltd v Marsden NO and others* 2013 ZAGPJHC 148.

[44] Wassman 37. *Koen and another v Wedgewood Village Golf and Country Estate (Pty) Ltd and others* 2012 (2) SA 378, Para 17. See also *Prospec Investment (Pty) Ltd v Pacific Coast Investment 97 Ltd* 2013 1 SA 542 (FB), Para 12.

[45] *Koen and another v Wedgewood Village Golf and Country Estate (Pty) Ltd and others* 2012 (2) SA 378, Para 17.

[46] *Employees of Solar Spectrum Trading (Pty) Ltd v Afgri Operations Ltd; In re Afgri Operations Ltd v Solar Spectrum Trading (Pty) Ltd* unreported case 6418/11, 18624/11, 66226/11 (GNP), Para 17.

The key case to take note of is *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd*[47], where Eloff JA noted that each case brought before a court needs to be judged independently to each other[48], and demanded further "reasonable grounds for the prospect" of success of business rescue.

Eloff JA went further and created further requirements that should be met to show a court that a reasonable prospect exists in the company continuing, which are as follows:[49]

1. The costs associated with continuing with the intended business,
2. The availability of cash in order to meet day to day needs,
3. The availability of other resources, and
4. Reasons why the business rescue plan has a prospect of success.

The above checklist provided the courts with a much-needed guideline, seeing as to how new the concept of business rescue was at the time. However, it could be said that the checklist was too demanding, and a simpler approach was needed.[50]

It appeared that Brand FDJ was of the same view in the case of *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd*[51], which was the first business rescue matter to be heard in the Supreme Court of Appeal. The matter emanated from the South Gauteng High Court where Claassen J refused the business rescue application on the basis that the winding up of a company would inevitably occur unless the business rescue application was successful.[52]A contrasting view was held by Brand FDJ where he held that an application for business rescue should succeed if the applicant can prove that business rescue will restore the company to a healthy state, and

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[47] 2012(2) SA 423 (WCC).

[48] Ibid para 24.

[49] Ibid.

[50] *Prospec Investments (Pty) Ltd v Pacific Coast Investments 97 (Pty) Ltd* 2013(1) SA 542. See also *Zoneska Investments (Pty) Ltd t/a Bonatla Properties (Pty) Ltd v Midnight Storm Investments 386 Ltd* (9831/2011, 7811/2012) [2012] ZAWCHC 163; [2012] 4 All SA 590 (WCC).

[51] 2013 ZASCA 68.

[52] Ibid para 1.

that it will provide a better return for creditors and shareholders than liquidation would.[53] He further added an important principle that a reasonable prospect means reasonable grounds rather than speculation, which reasonable grounds the applicant must be able to prove.[54] It is contended that this judgment is in line with section 7(k) of the Act which indicates that one of the goals of the Act is to *"provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders"*.[55]

Considering the preceding discussion, it is evident that the main obstacle that is preventing the granting of a business rescue order is the ambiguity that lies in the definition of "reasonable prospect". *Joubert*[56] is of the view that one of the contributing factors to the ambiguity lies in the fact that the bar to establish that there is in fact a "reasonable prospect" was set too high by Eloff JA in the *Southern Palace* case, and courts after this have used this as a benchmark, which in his view is a threshold too high.

2.2.4 Requirements to be Met of an Affected Persons

The threshold in proving that a company should be placed under business rescue by an affected person is far higher than it is for an application made by the board of directors.[57] The reason for this is that there appears to be only two requirements needed to be met by the board of directors to initiate business rescue, as opposed to an affected person who has to meet four requirements.

An affected person seemingly not only has to prove that a company is "financially distressed" and that there is a "reasonable prospect for rescuing the company," but the Act explicitly provides that they need to provide evidential proof that the company was

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[53] Ibid para 25.

[54] Ibid para 29.

[55] Delport, Henochsberg *on the Companies Act 71 of 2008 Durban*: LexisNexis, 2015. (Hereinafter Delport, *Henochsberg*).

[56] Joubert EP '"Reasonable possibility" versus "reasonable prospect": Did business rescue succeed in creating a better test than judicial management?' 2013, at pg.562-563.

[57] *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* 2012 (2) SA 423 (WCC).

not able to fulfil an amount of payment in terms of an obligation.[58] However, this requirement is not explicitly required for a board of directors. Though the question arises that inadvertently in order to prove that a company is "financially distressed," one would have to shed light on its inability to pay debts that are due and provide evidential proof thereof. As such, this requirement should be explicitly provided for in section 129(1) of the Act.

In addition, an affected person also has to prove that there is a "reasonable prospect for rescuing the company," which may prove difficult given the fact that an employee or creditor of the company may not fully know the financial status of the company, as would a director of the company. In this circumstance, the affected person is put on the proverbial "back foot", and the Act should assist the affected person in this regard by providing a provision that assists the affected person in establishing the current financial situation of the company by directing, for example, that a financial auditors report be provided.

2.2.5 Meaning of Just and Equitable to do so for Financial Reasons

One of the criteria that the courts have to be satisfied with when adjudicating on the decision to grant a business rescue order from an application made by an affected person is to establish whether it is "just and equitable to do for financial reasons"[59].

This provision is vague as there is no definition provided in the Act regarding "for financial reasons." Furthermore, the provision can be deemed as unnecessary as the criteria is already covered in "financially distressed"[60], and this would already cover the reasons that the company considered when opting for business rescue[61]and it would be difficult to determine other circumstances that are not are not covered already in "financially distressed".[62] Further, the Act is silent on whether these reasons must be

[58] Section 131(4)(a)(ii) of the Act.

[59] Section 131(4)(a)(iii) of the Act.

[60] Section 131(4)(a)(i) of the Act.

[61] Henochsberg on the Companies Act 71 of 2008.

[62] Kunst et al. 'Meskin Insolvency Law and its operation in Winding Up' (loose-leaf 2016 update 18.3.2.

related to the financial hardships not covered in "financially distressed"[63], thereby creating more vagueness.

The above vagueness contention of "for financial reasons" is supported in *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd*[64], where Brand FDJ was of the opinion that this was going to ultimately lead to interpretational disputes in the future.

3 CONSEQUENCES OF BUSINESS RESCUE PROCEEDINGS

There are many consequences that follow with the commencement of business rescue, and this chapter will briefly deal with a few to illustrate the potential impact that business rescue has on businesses. This chapter's main focus will be the suspension of liquidation proceedings upon the institution of business rescue proceedings.

3.1 General Background

It is important to note that when business rescue commences, the consequences that follow are substantial. These include, but not limited to, the appointment of a business rescue practitioner, post-commencement finance, effect on employees, effect on creditors, and *moratorium*. Since this dissertation is mainly focusing on suspension of liquidation proceedings, the consequences above are going to be discussed briefly without getting into depth. It is not possible to discuss these consequences in detail in one dissertation. They are mentioned and briefly discussed to show that there are several consequences one needs to be aware of once the company starts business rescue proceedings other than suspension of liquidation proceedings by business rescue proceedings.

[63] Loubser A *The business rescue proceedings in the companies act of 2008: Concerns and questions (part 1)* 2010(3) J. S. Afr. L. 501 (2010), *TSAR* 511.

[64] 2013 ZASCA 68.

3.1.1 Appointment of the Business Rescue Practitioner

The appointment of a business rescue practitioner may be done in two ways, namely by passing of resolution[65] or by court order[66]. The benefit of having a business rescue practitioner is that they are an independent party who can bring a fresh new perspective into the company. Therefore, it can be said that the role played by the business rescue practitioner is important in the success of the business rescue process. This is because once the company commences with business rescue proceedings, a business rescue practitioner undertakes temporary supervision of the business[67] and this person takes full management control.[68] In doing so, there are a number of duties and functions that are expected of a business rescue practitioner. These include, amongst others, full control of the company in place of the existing management and board of directors[69]; delegation of any power or function to a person who was part of the board of directors or pre-existing management of the company[70]; and the removal or appointment of any person from office.[71]

Accordingly, it is important that a business rescue practitioner with the requisite knowledge of the area of business that the company operates in be appointed.[72]

i. Post-commencement finance

The goal of business rescue is to make the company viable again, and without having a work force, it will be difficult for the company to be able to generate income to sustain themselves. Post-commencement finance is money given the company after business

[65] Section 129(3)(b) of the Act.

[66] Section 131(5) of the Act.

[67] Section 128(1)(d) of the Act.

[68] Section 140(1)(a) of the Act.

[69] Ibid.

[70] Section 140(1)(b) of the Act.

[71] Section 140(1)(c)(i) and (ii) of the Act.

[72] Donnelly A 'The Do's and Don't's of Business Rescue' 23 October 2018. Retrieved from *https://www.wylie.co.za/articles/the-dos-and-donts-of-business-rescue/.*

rescue proceedings have started. It has been said that post-commencement finance is a "fundamental requirement for successful business rescue."[73] Loubser argues that,

> '*Attempting to rescue a business without adequate capital is like trying to drive a car without fuel. [N]o matter how well designed and strong it is, there is only one way you can go, and that it is downhill. Because rescuing a company requires that the business should continue trading, and that, in turn, requires working capital. [E]mployees must be paid to prevent them from leaving, suppliers will not deliver unless they are paid in cash and the providers of essential services such as water and electricity have to be paid to ensure uninterrupted services*.'[74]

Given this fact, section 135(1) of the Act plays a pivotal role in ensuring that employees and running expenses are paid to maintain the company to give it an opportunity to try and become viable.[75]

ii. Effect of business rescue on employees

Business rescue proceedings seemingly also have the objective to also protect employees[76] with provisions like section 135 and section 136(1)(a) of the Act. In particular, section 136(1)(a) of the Act provides for employees to have the same terms and conditions in their employment contract upon the commencement of business rescue proceedings, save to state where there has been "*changes occur in the ordinary course of attrition*[77]" or "*the employees and the company, in accordance with applicable labour laws, agree different terms and conditions*[78]".

Furthermore, the legislature specifically catered for the rights of employees, which is envisaged in section 144 of the Act, which provides, amongst others, for employees to

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[73] Levenstein *An Appraisal of the New South African Business Rescue Procedure* (Unpublished LLD thesis, University of Pretoria 2016) at 494.

[74] Loubser A 'Post commencement financing and the ranking of claims: A South African perspective' in R Perry (ed) *European Insolvency Law: Current Issues and Prospects for Reform* (2014) at 29.

[75] Pretorius and Rosslyn-Smith 'Expectations of a business rescue plan: international directives for Chapter 6 implementation' 2014 *Southern African Business Review* 132.

[76] Cassim et al. *Contemporary Company Law (2nd ed)* 884.

[77] Section 136(1)(a)(i) of the Act.

[78] Section 136(1)(a)(ii) of the Act.

be able to exercise their rights in terms of the Act whether or not they are part of a union[79]. This ensures that employees become unsecured preferred creditors in the event that "any remuneration, reimbursement for expenses or other amount of money" is owing before the beginning of business rescue, which has not been paid[80]. In addition, of most importance is the participation of employees throughout the business rescue process to ensure that their interests are safeguarded.[81]

As previously stated, employees are the most important part of a business and the success of the business relies heavily on the performance and attitude of employees. By the legislature, specifically placing a provision that safeguards employees emulates their importance even more by ensuring the retention of employees. This provision effectively assists the business rescue practitioner, as an additional burden of finding new employees who are not trained in the business is alleviated.

iii. Effect of business rescue on creditors

Despite the inherent move away from the creditor "friendly approach" that is embodied in the Act, the Act does make provision for the protection of creditors[82], which provides an important balance of protection for the both creditors and the company.

Section 145 of the Act actively makes provision for the involvement of creditors in the process by stating that creditors are entitled to be notified and informally or formally participate in court proceedings[83], as opposed to them being mere bystanders in the process without having a say in how the business rescue process unfolds. The importance of this provision is that creditors obviously want the most effective business rescue that will yield the best return for them, entailing that they are invested in the matter and their contribution in the process will be valuable and of assistance to the business rescue

[79] Section 144(1) of the Act.

[80] Section 144(2) of the Act.

[81] Section 144(3) of the Act.

[82] *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* (2013) 3 All SA 303 (SCA).

[83] Section 145(1) of the Act.

practitioner. This is emulated in the Act by affording creditors the opportunity to accept or reject the business rescue plan.[84]

iv. General *Moratorium*

According to Cassim, a *moratorium* against a company under business rescue is a "stay on legal proceedings or executions against the company, its property, assets and on the exercise of the rights of creditors of the company."[85] The purposes of the *moratorium* is to allow the company breathing space to rearrange their affairs without having looming legal proceedings hanging above them, which could have serious financial implications and hinder the business rescue process.[86]

The objective is to try to protect the company from any proceedings and actions that may be taken against the company while it is under business rescue. Consequently, *moratorium* is found in section 133 of the Act. This section provides that *"during business rescue proceedings, no legal proceeding, including enforcement of action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or proceeded with in any forum…"* The *moratorium* provided by section 133(1) goes further and influences section 131(6) of the Act. It is for this reason that this dissertation provides a detailed analysis of section 131(6).

3.2 What are the requirements of liquidation?

Section 131(6) of the Act sets out the provision that if a company has already commenced with liquidation proceeding, and a business rescue application is thereafter brought, then the business rescue application effectively suspends the liquidation application until the business rescue application has been adjudicated on or business rescue proceedings has ended.

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[84] Section 145(2) of the Act.

[85] FHI Cassim (managing ed) Contemporary Company Law 2ed (Cape Town: Juta 2012) at 878.

[86] See *Merchant West Working Capital Solutions* (*Pty*) *Ltd v Advanced Technologies and Engineering Company Ltd* 13/12406, 10 May 2013 (GSJ) at 4, V*an Zyl v Euodia Trust* (*Edms*) *Bpk* 1983 (3) SA 394 (T) at 397 and *Standard Bank of South Africa Ltd v A-Team Trading CC* 2016 (1) SA 503 (KZP) at 12).

Although this section appears to be clear and straightforward, it tends to create different interpretations if read carefully. There has been much debate surrounding this provision of the Act, as there lies a lot of ambiguity. The debate has evolved around the following:

3.2.1 Service of the Business Rescue Application to Suspend Liquidation Proceedings

The Act is silent on whether the issuing of a business rescue application or the service of it on the required parties in terms of section 131(2)[87] of the Act will result in the suspension liquidation proceedings. This silence of the Act has led to the courts having to adjudicate on this matter. However, differing views have emanated from the courts and clarity was not actually brought on this issue.

In the case of *Taboo Trading 232 (Pty) v Pro Wreck Scrap Metal CC*[88] (*Taboo Trading*), although the facts were different to that of *Absa Bank v Summer Lodge (Pty) Ltd*, [89] in that no application for provisional liquidation had been heard or granted, the court held that "a business rescue application is only deemed as having been made once the application has been lodged with the Registrar, served on the Companies and Intellectual Properties Commission (CIPC) and on affected persons."[90] This judgment took the correct viewpoint, as it took into consideration the intention of the legislature. It can be assumed that the reasons behind having the requirement of service of the business rescue application is to ensure fairness in that all parties are aware of the application and are placed in position that they can object if necessary.

However, this was not the stance taken in the case of *Blue Star Holding (Pty) Ltd v West Coast Oyster Growers CC*[91] (*Blue Star Holding*), which was an application brought for the winding-up of the Respondent company on the grounds that it is unable to pay its debts.[92]In this case, it appeared that the court overlooked the requirement of having to serve the business rescue application on CIPC and affected persons, and heard the matter nevertheless. This gives the impression that the mere issuing and lodging of

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[87] Read together with section 131 (6) of the Act.

[88] 2013 6 SA 141 (KZP).

[89] 2014 3 SA 90 (GNP).

[90] Para 29.

[91] 2013 6 SA 540 (WCC).

[92] Ibid para 1.

the business rescue application is sufficient to commence with business rescue proceedings. This then begs the question as to why there is a requirement to serve the business rescue application on parties, if the mere issuing and lodging with the Registrar is enough to commence proceedings with.

In the case of *Summer Lodge,* the court demonstrated that the mere issuing and service of the business rescue application might have the effect of suspending liquidation proceedings. However, a business rescue application cannot suspend a liquidation application.[93] The problem with this judgment is that the court was essentially stating that applying for a liquidation order does not amount to liquidation proceeding. Bezuidenhout argues that if the view of the court is to be taken, this may mean that applying for a liquidation order does not amount to the institution of liquidation proceedings.[94] Therefore, this would not prevent the company from adopting a resolution in terms of section 129(2)(a) of the Act, as no liquidation proceedings have commenced.[95] This is surely not the intention of the legislature.

If one takes into consideration the reasoning behind section 131(2) of the Act, it can be said that this section was created to ensure that business rescue applications are not brought to court without the knowledge of interested parties to ensure that the matter be ventilated in court with all parties' concerns taken into account. Section 131(2) is a key provision to ensuring fairness and upholding the rights of interested parties. To simply overlook such a provision, which is clearly written, cannot be correct in terms of the law. One has to look at the judgment in the case of *Standard Bank of South Africa v Gas 2 Liquids (Pty) Ltd*[96] (*Gas 2 Liquids*), where it was confirmed that service on the aforementioned parties was required before the application for business rescue could be deemed to have been made and liquidation proceedings suspended.[97] Taking this into account, section 131(2) of the Act clearly states that the application must[98] be

[93] Para 20.

[94] Bezuidenhout S 'Rescue the business before liquidation is considered' (2016) 561 *De Rebus* 23.

[95] Ibid

[96] 2017 2 SA 56 (GJ).

[97] Para 26.

[98] The legislature was unambiguous in its intention, and if there were room for leeway then the legislature would have stated that the application may be served on the company, CIPC and affected parties.

served on the company, CIPC and affected persons. As such, for a business rescue application to result in the suspension of liquidation proceedings, the application must be served on the company, CIPC and affected persons. The legislature was not ambiguous in this regard with the wording of section 131(2) of the Act.

3.2.2 Meaning of Liquidation Proceedings

The Act does not define the meaning of liquidation proceedings. However, according to *Polity*, it is the process in which a company is declared insolvent, voluntarily by the board of directors or involuntarily by a creditor through a court application.[99] It is important to note that this definition is a simplistic one. The fact that liquidation proceedings is not defined in the Act creates a lot of confusion and is left open to interpretation. The question that the courts have had to grapple with is whether the commencement of liquidation proceedings begins with the application being filed at court or are liquidation proceedings commenced with in the closing down of the company once the final liquidation order has been granted.

A number of cases have dealt with this issue and courts have reached different decisions on the issue. In the notable case of *Van Staden v Angel Ozone Products CC (in liquidation)*[100] (*Van Staden*), Legodi J was tasked with answering the question of whether liquidation proceedings could be interpreted to include the winding up process after a liquidator had been appointed. In this regard, Legodi J was of the view that there is a distinction between liquidation proceedings and winding up, though the winding up process should be viewed as a continuation of the liquidation proceedings.[101] Consequently, the court ruled that liquidation proceedings could be converted to business rescue proceedings regardless of at what stage the company was at in the liquidation process.[102]

Summer Lodge appeared to take a different view to that of *Van Staden.* Makgoba J was of the view that liquidation proceedings are only related to the process of winding up

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[99] 'The Process of Liquidation', available at *https://www.polity.org.za/article/the-process-of-liquidation*, accessed on 6 July 2017.

[100] 2013 4 SA 630 (GNP).

[101] Para 26.

[102] Para 30.

of the company, and not the actual process of adjudicating on whether or not a company should be placed in liquidation.

Richter v Bloempro CC and Others[103] (*Bloempro CC*) took a different view than *Summer Lodge* and *Van Staden*. Bam J held that section 131(6) of the Act could not affect the suspension of liquidation proceedings for the following reasons:

- Liquidation proceedings and business rescue are two vastly different concepts. Business rescue requires that the company become a viable concern or that there come about a better return for creditors. By a court already placing a company in liquidation, it implies that the court has already ruled that the company is insolvent and cannot become a viable concern. As such, the company would not meet the "financially distressed" criteria of business rescue.[104]
- The granting of a final liquidation order effectively takes away the *locus standi* of the company, entailing that an interim business rescue order could override a final liquidation order, which is something that the legislature could not have intended. Had the legislature intended that then it would have stated in section 131(6) of the Act, the inclusion of companies under liquidation.[105]

The views expressed in *Van Staden* and *Bloempro CC* differ in the sense that it appeared that *Van Staden* interpreted section 131 (7) of the Act and *Bloempro CC* section 131 (6) of the Act.[106]

On appeal, the Supreme Court of Appeal (SCA) in *Richter v Absa Bank Limited*[107] (*Richter*) seemingly overturned the High Court decision (*Bloempro CC)*, as Dambuza AJJA was of the following views:

- In section 132(1) of the Act, there is no indication that liquidation proceedings only mean proceedings that lead up to the final liquidation order.[108]

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[103] 2014 6 SA 38 (GP).

[104] Para 18.

[105] Ibid.

[106] Phungula S 'Liquidation over Business Rescue Proceedings' 2017 28 *Stellenbosch Law Review* 593.

[107] 2015 5 SA 57 (SCA).

[108] Para 6.

- Exception to Bam J's stance that a company effectively has no *locus standi* once a liquidation order has been granted, when in fact control over the company is handed from the directors of the company to the liquidator.[109]
- Section 136(4) of the Act made provision for the conversion of liquidation proceedings, even after the final order was granted, to business rescue proceedings as the liquidator becomes the creditor of the company upon conversion of proceedings.[110]
- In addition, the main reasoning behind overturning the High Court decision was based on the fact that Dambuza AJJA was of the view that "even after a final liquidation order is granted," a company may still be capable of being rescued[111], provided that there is a *bona fide* business rescue application.[112]
- Dambuza AJJA, also took into consideration the fact that if section 131(1) of the Act were to be considered as "liquidation proceedings could be converted into business rescue proceedings even after the final liquidation order had been granted," it could have negative consequences, such as repetitive disruptions. However, this to him did not justify having a restrictive approach to the Act.[113]

Considering the SCA judgement, it appears that a company can suspend liquidation proceedings even after a final liquidation order has been granted.[114]

There has been much debate surrounding the contentious judgment that was handed down by Dambuza AJJA, with some academics and courts of the view that it was indeed the correct approach that was taken.[115]

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[109] Para 10.

[110] Para 12.

[111] Para 15.

[112] Para 16.

[113] Para 16.

[114] Para 18.

[115] See Phungula S 'Liquidation over Business Rescue Proceedings' 2017 28 *Stellenbosch Law Review* 596, where he is of the view that the correct approach was taken, and evidence will guide the court in making the correct decision, See also Absa Bank v Summer Lodge (Pty) Ltd 2014 3 SA 90 (GNP) para 18, ABSA Bank Ltd v Makuna Farm CC [2014] 3 SA 86 (GJ) para 8.

It is difficult to ignore the susceptibility of abuse by the stance taken by Dambuza AJJA, due to the fact that in as much as the application must be *bona fide*, there is nothing in the Act that stops an applicant from making a frivolous application for business rescue, in an attempt to make a "last ditch" effort to suspend liquidation proceedings and frustrate creditors.

In addition, one has to give due cognisance to the fact that a court who has adjudicated and granted a liquidation order obviously gave due regard to all financial factors of the matter when handing down judgement. If the court were of the view that the company was not insolvent, the liquidation order would not have been granted. By allowing an essentially insolvent company to make use of business rescue is effectively undermining the Act and purposes of which business rescue was created. Business rescue is there to assist companies that have the potential of being viable and not those that have no potential of being rescued.

It is noted that Dambuza AJJA is of the view that circumstances may change from the time of liquidation application to the bringing in of the application for business rescue. However, the likelihood of this occurring is slim.

In addition, it is important to note that the winding up process of the company is a long-winded affair that can take many months if not years to finalize. To be able to suspend liquidation at any given time, including upon imminent finalization of liquidation proceedings after a substantial amount of time has been put into the winding up of the company, could not have been the intention of the legislature.[116]

The definition of business rescue and its purpose gives guidance, in that business rescue is there to cater for companies that have the potential to be rehabilitated and become financially viable. Business rescue does not cater for companies who have no prospect of being rehabilitated and who have been adjudicated to be insolvent. If this were the case, then the Act would have specially catered for it.

Further, as previously mentioned, if companies are allowed to suspend liquidation proceedings even after a final liquidation order has been granted by the launching of a

[116] van Niekerk B 'Launching business rescue applications in liquidation proceedings – (successfully) flogging a dead horse?'2015 *De Rebus* 50.

business rescue application, then this can lead to an abuse of process. The question therefore is how is this consistent with the aim of business rescue proceedings, which highlights the fact that a balance must be maintained on the rights and interests of all stakeholders. Applications for business rescue can be brought just to prolong the inevitable liquidation of a company and thereby undermining the rights and interests of interested parties.

If one looks at the reasoning behind Dambuza AJJA judgment, the following arguments against it can be raised:

- It is correct that in section 132(1) of the Act, there is no indication that liquidation proceedings only mean proceedings that lead up to the final liquidation order. However, the practicality behind liquidation has to be taken into account, in that liquidation proceedings are a long drawn out and winded affair that takes months or even years for a company to be "wound up". The fact that a company can be allowed to suspend liquidation proceedings just before being finally wound after months or years of creditors waiting to receive their money, cannot be fair or just.
- Even though section 136(4) of the Act makes provision for the liquidator to become a creditor of the company upon the conversion of liquidation proceedings to business rescue proceedings, misses the crux of the issue at hand. The issue does not surround payment but rather the fact that the work done by the liquidator can be effectively undone by the business rescue practitioner and thereby wasting more time and delaying the process.
- It has been said by Dambuza AJJA that a company may be able to be rescued even after a final liquidation order has been granted. The question that arises is what is the practical reality of this occurring given the current times that we find ourselves? When a company is deciding on whether to proceed with liquidation, it can safely be assumed that this is a well-thought-out process and that all alternative options and avenues are explored and exhausted prior to the making of the decision. For a company to suddenly change their mind after having gone through that process raises alarm bells that point to potential abuse of the business rescue process.

Dambuza AJJA himself conceded that there may be negative consequences should a company, where a final liquidation order has already been granted, be allowed to convert liquidation into busines rescue proceedings. As mentioned previously, these negative consequences were not fully ventilated in the judgement, and it important to unpack some of these negative consequences, which are not limited to the following:

- By allowing a business to , at any stage, convert liquidation proceedings to business rescue proceedings, can be tantamount to reckless trading in contravention of section 22 of the Act. This is due to the fact that despite the financial state of a business, who are technically insolvent by the virtue of having a liquidation order against them, can continue to trade.
- The longer that companies who are insolvent or on the verge of insolvency are allowed to trade, has a ripple effect on the economy. This is due to the fact the creditors of these companies are not receiving overdue payments, and this affects their business and could place them in a financial situation similar to that of the debtor. As previously mentioned, the Act in section 7 is there to promote and encourage businesses and the economy, but allowing businesses to trade in an insolvent manner that has a detrimental effect on other companies undermines the entire purpose of the Act.

Had Dambuza AJJA taken into account the aforementioned consequences in his judgment he would have realized the repercussions of his judgment in that the floodgates are left open for companies to abuse the business rescue process at their own will.

3.2.3 Part played by courts in business rescue

When matters are placed before courts to adjudicate on whether a company should be allowed to convert liquidation proceedings into business rescue proceedings, it is imperative and obvious that the finances of the company must be looked into in great detail.

This issue herein lies that Judges who are tasked with looking into these finances might not necessarily have the expertise and knowledge that is required to ensure that the correct judgments are made.

Without the significant expertise that is required to analyse businesses, it can cause judgments to be handed down that are detrimental to creditors and the economy at large.

It is submitted that specialised courts be established[117] to handle these types of matters, as with specialised courts that have been established to deal with, for example, income tax related matters.

3.2.4 Purpose of Business Rescue as envisaged by section 7(k) of the Act

As mentioned previously, section 7(k) envisages the purpose behind business rescue. However, it is also imperative to note that section 5(1) specifically makes mention that the Act is to be interpreted considering the purpose of section 7.

It is noteworthy to mention that the legislature would have not made such an emphasis on section 7 if it was not of importance, this section makes mention, amongst others, of promoting the economy (section 7(b)(i)), promoting investment in the country (section 7(c)), achieving social and economic benefits (section 7(d)) and in particular section 7(k) calls for not only the rescue of company but for it to be done in a manner that balances and rights of stake holders.

The legislature has made the intention behind the Act clear in that the Act is there to assist and encourage the promotion of businesses. However, one must look at circumstances independently of each other, as in some cases businesses have past the point of being viable and the only option available is to have these businesses cease trading.

Section 7(k) is an example of this as it could not have been the intention of the legislature, that a company who clearly does not have any prospect of rescuing itself should be allowed to convert liquidation proceedings into business rescue proceedings. This type of process undermines the purpose brought about by section 5(1) and section 7(k) of the Act, as this prolongs the winding up process of a company to the detriment of creditors.

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[117] Nyoni S *Business Rescue after the commencement of liquidation proceedings: A legal conundrum in South Africa?* (LLM dissertation 2018 University of Pretoria) 48.

As can be seen, there is much debate around the suspending liquidation proceedings by initiating a business rescue application. The courts have attempted to bring some clarity on the matter, and currently the judgment of *Richter* is the one that stands.

In this regard, the clarity surrounding the issue of at what stage of liquidation proceedings can an application for business rescue suspend liquidation proceedings has to be left to the legislature to amend the provisions to be more specific in the matter, thereby eliminating the confusion that surrounds this matter.

The importance of effecting such amendment is more important now than ever, given the current economic climate that we find ourselves in, during the CoVid-19 pandemic that the world is facing. Thousands of companies in South Africa are going to be susceptible to liquidation and business rescue proceedings. Therefore, clarity is needed to alleviate the pressure on the courts when adjudicating the thousands of matters that are inevitably going to come through its doors.

4 FURTHER COMMENTS

This chapter aims to look at additional pitfalls in the Act that the legislature ought to deal with to ensure that clarity and certainty prevails in future circumstances, as opposed to leaving these interpretational issues with the courts to deal with, as this can lead to more uncertainty than clarity.

4.1 Control of the Company upon the Suspension of Liquidation Proceedings

The Act is silent on who has control of the company once liquidation proceedings are suspended. As a result of the silence in the Act, direction has to be drawn from case law.

In *Ex Parte Nell N.O*[118], the question of who has control of the company pending the appeal regarding a liquidation order that was granted on the back of an opposed business rescue application was answered.

Naturally, the company and the business rescue practitioner opined that control of the company vested in the business rescue practitioner on the basis of section 18(1) of the Superior Courts Act, No 10 of 2013 (Superior Courts Act). On the opposing view, the creditors and liquidators were of the view that the Master should retain control of the company.[119] In addressing the views held by the respective parties, Tuchten J in his judgment noted that section 150 of the Insolvency Act, No 24 of 1936 (Insolvency Act) was enacted to regulate appeals against sequestration and that section 150(3) of the Insolvency Act, provides that the provisions of the Insolvency Act apply, regardless of the presence of an appeal.[120]

In addition, and of importance is that Tuchten J highlighted the fact that section 129(1) of the Act favoured the interest of the company, and this could not outweigh the provision of intentions of section 18(1) of the Superior Courts Act. As a result, Tuchten J held that control of the company be with the liquidator.

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[118] 2014 6 SA 545 (GP) 620.

[119] Para 9.

[120] Para 17

In many circumstances, it can be found that courts do not take practicality of situations into account together with the law. However, the approach taken by Tuchten J is a modern one, where practicality of how the long drawn-out process of an appeal affects the running of the business in the interim was considered. He not only appreciated this factor but also took heed of the intention behind prevailing legislation in coming to his ruling.

A similar stance (though differing facts) regarding with powers vesting with the liquidator was taken *Van Rensburg N.O and Another v Cardio-Fitness Properties (Pty) Ltd and Others*[121], where Kgomo J ruled that liquidation proceedings are suspended and not the actual function of the provisional liquidator.[122]

On the opposing view of the stance taken by the aforementioned courts was that of *Maroos v GCC Engineering (Pty) Ltd*[123], where Fabricius J held that Kgomo J's judgment in the *van Rensburg* case was incorrect, as was the judgment in *Knipe and Another v Noordman NO and Others*[124]. The reasoning for this was that the court was of the view that liquidation proceedings include both court proceedings and the process of winding up a company. By virtue of section 131 (6) of the Act, this entire process is suspended, which includes the suspension of the powers of the liquidator. As such, the powers and company assets fall onto the Master of the High Court. However, Fabricius J was of the view that the Master cannot assume such powers of the previous directors, and the powers should be re-vested with the particular directors, awaiting the finalization of the pending business rescue application.[125]

The judgment handed down by Fabricius J is a peculiar one in the sense that the decision is not supported by the Act, as the powers of the company in the differing circumstances fall to the liquidators, or the business rescue practitioner, or failing which the Master of the High Court. This judgment could have had far-reaching consequences for creditors of companies, as it is untenable to imagine that it could have ever been the intention of

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[121] (46194/13)[2014] ZAGPJHC 40 (4 March 2014).

[122] *Van Rensburg N.O and Another v Cardio-Fitness Properties (Pty) Ltd and Others* (46194/13)[2014] ZAGPJHC 40 (4 March 2014) 52.

[123] 2017 36777/2017 ZAGPPHC 297.

[124] 2015 (4) SA 338 (NCK).

[125] Para 15.

the legislature that it would want to vest power back into the hands of a person who was responsible for the financial predicament that the company finds itself in in the first place.[126]

It is with relief that the judgment was taken on appeal in *GCC Engineering (Pty) Ltd and Others v Maroos and Others*[127], where Seriti J held that suspension of liquidation proceedings in terms of section 131(6) of the Act *"does not change the status of the company in liquidation nor does it suspend the court order that placed the company under liquidation in the hands of the Master in terms of section 141(2)(a)(ii) of the Act. The appointed provisional joint liquidators must proceed with their duties and functions to protect the assets of the company for the benefit of all the creditors of the company."* [128]

It appears that the courts took the correct approach when deciding on the control of the company during the suspension of liquidation proceedings. It would be unsound to think that the legislature meant for the company to be left in limbo whilst the long drawn-out process of appointing a business rescue practitioner occurred. In addition, with the liquidator being allowed to manage the company whilst the appointment of the business rescue practitioner occurred, it would ensure that the business still ran and there would be a salvageable company for the business rescue practitioner to try to rescue. In addition, the differing judgments highlight the importance of how hazardous the interpretation of law can be when the law is ambiguous or silent in this case.

4.2 Abuse of Process

One of the most pertinent issues surrounding the institution of business rescue proceedings during liquidation proceedings is the abuse of process that can occur with frivolous applications that can be brought to court to delay the inevitable liquidation of a company.

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[126] Moloi T *Control of a Company During the Period When Liquidation Proceedings are Superseded by a Business Rescue Application* (LLM dissertation, University of Johannesburg 2019) at 24.

[127] 2019 (2) SA 379 SCA.

[128] G*CC Engineering (Pty) Ltd and Others v Maroos and Others* 2019 (2) SA 379 SCA 15.

This issue was recently highlighted in *Standard Bank of South Africa v Gas 2 Liquids (Pty) Ltd*[129], where Satchwell J demonstrated that the possibility of a business rescue application being brought by an obstructive debtor to hinder inevitable liquidation and frustrate creditors is high.[130]

In as much as Dambuza AJJA in *Richter*[131] sought to address the issue of abuse by debtors bringing frivolous business rescue applications by stating that applications need to be *bona fide*[132], this still does not stop the abuse of business rescue applications. The reason lies in the fact that once a business rescue application is launched during liquidation, the matter still has to be examined in court and, if frivolous, it will waste the court's time, and unnecessarily disrupt liquidation proceedings.

It is important for the courts and legislature to look at the practically of legal proceedings and how they unfold when making important rulings such as this one, and the fact you cannot rely on the good nature of people not to abuse the system, there needs to be more concrete criteria in the legislation to ensure that this abuse is curbed from the onset.

Taking the above loopholes in the Act into account, such concrete criteria in the legislation could be the inclusion of a specific provision as to when the preverbally line in the sand is drawn as to when liquidation proceedings can be converted into business rescue.

It is submitted that once a liquidation order has been granted by the courts, that the option to convert liquidation proceedings into business rescue proceedings should cease at that point. The reasoning behind this is that if a court makes a decision that a company is insolvent and should be wound up, it must seriously consider all factors and the decision made is thoroughly consider one.

The argument against the aforementioned submission could be that a company after a liquidation order suddenly finds itself in a far better position and business rescue

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[129] (45543/2012) [2016] ZAGPJHC 38; 2017 2 SA 56 (GJ) 5.

[130] See also *Investec Bank Ltd v Bruyns* 2012 (5) SA 430 12 and *Blue Star Holdings Ltd v West Coast Oyster Growers CC* 2013(6) SA 540 20.

[131] 2015 5 SA 57 (SCA).

[132] Para 16.

becomes a more viable option. In this regard, the legislation can make provisions to cater for this exception by stipulating certain criteria to convert liquidation into business rescue after a liquidation order has been granted. Such criteria could include something like that found in section 4 of the Act regarding the solvency and liquidity test.

If the aforementioned suggestions are taken into account, then hopefully the abuse of business is curbed.

5 CONCLUSION

This study was aimed at critically analysing the institution of business rescue proceedings during liquidation proceedings and looking at whether the decisions made by the courts regarding this were correct. It could be said that the introduction of business rescue proceedings in the Act was brought about to afford companies who had the reasonable prospect of turning their misfortunes around an opportunity to "recoup", and trade as opposed to closing down their operations completely amounting to significant job losses and a ripple effect on the economy. If this is correct, and there is nothing to suggest differently, it would appear that the intention of the legislature was genuine in wanting to assist financially distressed companies with an alternative.

However, despite the good intentions shown by the legislature through the introduction of Chapter 6 of the Act, there are significant loopholes in the Act pertaining to Chapter 6 and more, especially section 131(6) of the Act. This is highlighted in the fact that reliance on the courts had to be called upon in order to seek clarity on section 131(6) of the Act. After a number of different High Court judgments, the judgment in *Richter v Absa*[133] made the ruling that business rescue proceedings can be instituted at any time during the liquidation process. Dambuza AJJA attempted to address the potential issue of abuse by stating that *bona fide* applications should only be allowed. However, it appears that this warning is merely just a warning, and there are no legislative criteria governing the abuse of the section. It is simply left to the good will of people. Applications, whether *bona fide* or not, will still have to be placed before the courts for and adjudication. It is the conclusion of this dissertation that this may inevitably waste

[133] 2015 5 SA 57 (SCA).

the court's precious time. The judgment did not divulge and examine thoroughly the repercussions of allowing the institution of business rescue proceedings at any stage during liquidation. The judgment merely made a statement about there being a risk of potential abuse but did not consider the stark reality of how likely this would be.

Taking the above into account, the judgment handed down by Dambuza AJJA is the judgment that the lower courts are bound by given the *stare decisis* doctrine, despite differing views expressed by lower courts.[134]

Given the issues that circulate around this section, the recommended way forward could be for the legislature to provide stringent criteria that needs to be met in order to make use of section 131(6) of the Act. Alternatively, the legislature could change the wording of the section to include at what specific point in liquidation can business rescue proceedings be instituted. This would put all our curious minds at ease, as this would probably be an indication of its original intention at the time of promulgation of the section. However, in the interim the judgment handed down by Dambuza AJJA is what has been provided as guidance, whether or not the belief is that it is the correct decision.

[134] See *Van Der Merwe v Zonnekus Mansion (Pty) Ltd* 2015 3 All SA 569 (WCC) para 17, where Ferreira J held that "I am bound by the Richter SCA judgment, even though I respectfully differ therewith, given the reasoning in the judgments of Bam J and Rogers J referred to *supra*." See also *Molyneux and Another v Patel*.

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