THE RICHTER JUDGMENT:

An analysis of section 131(6) of the Companies Act

by

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A dissertation submitted in partial fulfilment of the requirements
for the degree

MAGISTER LEGUM

in the subject

CORPORATE LAW

in the

FACULTY OF LAW

at the

UNIVERSITY OF JOHANNERSBURG

SUPERVISOR: **PROF J CALITZ**

2016

DECLARATION

I hereby declare that this mini-disertation submitted for the LLM degree at the University of Johannesburg, apart from the help recognised, is my own work and has not been submitted for any other module or degree at this university or at any other university.

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DEDICATION

I wish to dedicate this mini-dissertation to my late mother Selinah Motsai for nurturing me into the woman I have grown to be. She has always encouraged me to study further and taught me that the beauty about learning is that no one can take your education away from you.

ACKNOWLEGDEMENTS

Thanks are due foremost to my supervisor, Professor Juanitta Calitz, without whose careful guidance, astute comments, patience and kind words, the completion of my mini-dissertation would have been far more difficult.

I would like to acknowledge my business partners at MMMG Attorneys for their valuable feedback and discussions on this mini-dissertation. Thank you for allowing me to use you as my sound boards and for vetting my work.

My special thanks go to Dr Lehumo Makwela who stood by me through trials and tribulations; and my sister Khutso Motsai for being my pillar of strength. To my late mother, thank you for nurturing me into the woman I am today and for also teaching me that the key to success in life is education.

ABSTRACT

The initiation of the Companies Act 71 of 2008 (the Act) has fundamentally changed South African company law and consequently there is still a there is a lot of grey areas and uncertainty which is yet to be cleared up by the courts in their interpretation of the current law by interpreting the law.

The Act in chapter 6 introduces the concept of business rescue which provides for the rescue and rehabilitation of financially distressed companies from distress and ultimately liquidation proceedings. Prior to the adoption of the business rescue regime, financially distressed companies in South Africa had limited alternatives to their disposal. Companies now have the option to adopt and follow a rescue proceedings plan if the company is in financial distress and needs assistance in saving it from insolvency and ultimately liquidation proceedings.

This mini-dissertation looks at the decision of the Supreme Court of Appeal in *Richter v Absa Bank Limited*, the application for business rescue during liquidation proceedings, inter alia the provisions of section 131(6) of the Act, and the abuse of business rescue by entities in an effort to starve liquidation and frustrate creditors. The Act does not define the concept liquidation proceedings and/or what it entails and court decisions that grappled with its meaning in this context have reached divergent conclusions. The mini-dissertation concludes that the ambiguity created by the confusing use of the terminology in section 131 is a cause for concern and consequently a judicial amendment and/or an explanatory note is long overdue.

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1. INTRODUCTION

The introduction of the new Companies Act 71 of 2008 (the Act) brought with it the novel addition of an alternative route to the traditional one of liquidation. The Act came into effect on 1 May 2011. Prior to the enactment of the Act, judicial management served as the mechanism used to help financially distressed companies avoid liquidation.[1] In an effort to improve and modernise its company law, South Africa has now adopted and developed a business rescue regime similar to those found in foreign jurisdictions, most notably the United Kingdom (UK) and the United States (US).[2] One of the main objectives of the business rescue regime as envisaged in the Act is to render it possible for companies in financial distress to avoid winding-up and to be restored to commercial viability.[3] The introduction of the business rescue regime has unfortunately led to considerable abuse of the procedure wherein affected persons are trying to frustrate liquidation and avoid winding-up of companies. There has been a plethora of applications by businesses taking advantage of and exploiting this new system with the aim of avoiding liquidation.[4]

In terms of section 131(6) of the Act, if liquidation proceedings have commenced by the time an application for business rescue is brought, the application for business rescue will suspend those liquidation proceedings.[5] Taking into account the relief granted by section 131(6), an application for business rescue can be brought merely for the purpose of delaying or suspending existing liquidation proceedings.[6]

In contrast, section 129(2)(a) of the Act provides that, business rescue proceedings may be launched only if no liquidation proceedings have been initiated by or against the company.[7] The underlying intention of this provision was to minimise the exploitation of the process by companies placing themselves under liquidation for *mala fide* purposes.[8]

The court *a quo* in *Richter v Absa Bank Limited*[9] held that it was not competent to apply for business rescue after the issue of a final winding order. However, the Supreme court of

[1] s 427 of the Companies Act 61 of 1973; see also Loubser n 21 below 138 and *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd* (2001) 1 All SA 223 (C) at 238.
[2] Joubert n 7 below 550; see also Loubser "Tilting at windmills? The quest for an effective corporate rescue procedure in South African law" 2013 *SA Mercantile Law Journal* at 440 for a detailed discussion of the origin of reorganisations.
[3] s 128(1)(*b*) of the Act; see also *Southern Palace Investments* 265 case n 28 below 2.
[4] See *Absa bank Ltd v Newcity Group* n 6 below at 28 and *Swart* case n 172 below.
[5] Stoop n 107 below 330.
[6] See *Absa bank Ltd v Newcity Group (Pty) Ltd* [2012] ZAGPJHC 144 (18 August 2012) (GSJ) at 28.
[7] Stoop n 107 below 330; see also Joubert "Reasonable possibility versus reasonable prospect: Did business rescue succeed in creating a better test than judicial management?" 2013 *THRHR* 553.
[8] See Meskin n 49 below at 458 and *Sulzer Pumps* case n 12 below at 28.
[9] (20181/2014) 2015 ZASCA 100 (01 June 2015) - hereafter referred to as *Richter*.

appeal overturned the court *a quo*'s decision and held that there is no sensible justification for drawing the proverbial 'line in the sand' between pre and post final liquidation in circumstances where the prospects of success of business rescue exist.[10] It was for these reasons that the court found that a proper interpretation of liquidation proceedings in relation to section 131(6) of the Act must include proceedings that occur after a winding up order to liquidate the assets and account to creditors, up to deregistration of a company.[11]

This approach is different from the approach followed by the High Court in the case of *Sulzer Pumps (South Africa) (Pty) Limited v O & M Engineering CC.*[12] In *Sulzer Pumps,*[13] the court held that a business rescue application must be brought at the first available opportunity and must not be brought as a knee-jerk reaction to an application for liquidation as was done in this case. The Court was convinced that the business rescue application was brought to thwart the liquidation application.[14]

It follows from the above decision that the whole business rescue application balances on the court's discretion and it is ultimately within the court's discretion to dismiss an application for business rescue when it suspects that it is illegitimate and ill-founded.[15]

2. BACKGROUND

The remedy of judicial management was originally introduced in South African law under the Companies Act 1926[16] and retained in the 1973 Act[17] with the hope of restoring companies in financial distress to successful concerns. However, according to Smits,[18] in practice judicial management has been a spectacular failure, invariably being followed by the winding up of the company in question with the attendant collateral damage. Only a few judicial management orders resulted in the saving of companies experiencing financial difficulties.[19] Bradstreet[20] criticised judicial management for the absence of practicality, flexibility and effectiveness. Loubser[21] on the other hand also argued that judicial management needed a

[10] *Richter* case n 9 above 17.
[11] *Richter* case n 9 above 18.
[12] 2015 JOL 328 25 (GP).
[13] n 12 above.
[14] *Sulzer Pumps* case n 12 above at 28.
[15] See also *Absa bank Ltd v Newcity Group* case n 6 above at 28.
[16] Companies Act 46 of 1926.
[17] Companies Act 61 of 1973.
[18] Smits "Corporate Administration: A Proposed Model" (1999) 32 *De Jure* 80.
[19] *Richter* case n 9 above 13.
[20] Bradstreet "The new business rescue: Will creditors sink or swim" 2011 (2) *SALJ* 353.
[21] Loubser "Judicial Management as a Business Rescue Procedure in South African Corporate Law" 2004 *SA Mercantile Law Journal* 138.

substantial reform. Following the failure of the judicial management system, the South African company law was in need of an effective corporate rescue procedure.[22]

In an attempt to modernise and improve the failing judicial management and avoid the adverse consequences of liquidation, South Africa adopted the concept of business rescue.[23] The business rescue regime has been developed from similar concepts to those found in other foreign jurisdictions, in particular, the UK and the US.[24] Business rescue replaces judicial management which has been criticised for being too limited and a spectacular failure.[25] The new business rescue procedure encapsulated in Chapter 6 of the Act has been designed 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.[26]

Business rescue proceedings are materially different from the requirements for a supervision order under the judicial management model.[27] The relief granted by the business rescue provisions in Chapter 6 of the Act creates a mechanism by which a company in financial distress will be afforded an essential breathing space and avoid going into liquidation while a business rescue plan is implemented by a business rescue practitioner.[28]

The court in *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd*[29] makes the observation in comparing the recovery requirement in relation to judicial management and business rescue that the requirement in respect of judicial management is a reasonable probability while in respect of business rescue it is a reasonable prospect indicating that the use of different language in this later provision indicates that something less is required and that the recovery should be a reasonable possibility. In judicial management the creditor was entitled to a liquidation order and a judicial management order would only be granted in exceptional circumstances. With business rescue, the business rescue procedure is the preferred option to liquidation. Accordingly, the new business rescue procedure no longer suffers from judicial

[22] Joubert n 7 above 551.
[23] The Act introducing the business rescue regime became effective in South Africa on the 1st of May 2011.
[24] Joubert n 7 above 551.
[25] Smits n 18 above.
[26] s 7(*k*) of the Act.
[27] Bradstreet "The leak in the chapter 6 lifeboat: Inadequate regulation of business rescue practitioners may adversely affect lenders' willingness and the growth of the economy" 2010 22 *SA Mercantile Law Journal at* 197.
[28] *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd* [2012] JOL 28893 (WCC) at 1.
[29] n 28 above 20 and 21.

management's flaw of dependence on the essentially static and expensive process associated with the practice of law.[30] The new business rescue addresses the need for reform, and embraces international trends in corporate reorganisation.[31]

3. PROBLEM STATEMENT

The Supreme Court of Appeal in *Richter v Absa Bank Limited*[32] upheld an appeal against a judgment of the Gauteng High Court Pretoria which held that no application for business rescue may be brought after a final order of liquidation has been granted against a company. The issue to be decided was whether it is competent to apply for business rescue in terms of section 131 of the Act after a final liquidation order has been granted against a company.[33]

Business rescue, as defined by the Act, aims to facilitate the rehabilitation of a company that is financially distressed by providing for:[34]

a) the temporary supervision of the company and management of its affairs, business and property by a business rescue practitioner,
b) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession, and
c) the development and implementation, if approved, of a business rescue plan to rescue the company by restructuring its business, property, debt, affairs, other liabilities and equity.

In terms of section 131(6) a court application to begin business rescue proceedings may be made even after liquidation proceedings have been commenced, and this will have the effect of suspending the liquidation proceedings until the court has refused the business rescue application, or if it is granted, until the business rescue proceedings have ended.[35] As a result of to the alleviation afforded by the provisions of section 131(6) of the Act, allowing a business rescue application at any stage of liquidation proceedings, the process is prone to abuse by companies and affected persons.[36]

This dissertation looks at the court decision in *Richter v Absa Bank Limited,*[37] the application

[30] Bradstreet n 27 at 211.
[31] Bradstreet (n 20 (2011)) 378.
[32] n 9 above.
[33] *Richter* case n 9 above 1.
[34] s 128(1)(*b*) of the Act.
[35] Stoop n 107 below 330.
[36] *Newcity Group* case n 6 above.
[37] n 9 above.

for business rescue during liquidation proceedings, *inter alia* the provisions of section 131(6) of the Act, and the abuse of business rescue by entities in an effort to starve liquidation and frustrate creditors.

4. THE *RICHTER* JUDGMENT

4.1. Facts

In September 2012, the Free State High Court granted a final liquidation order against Bloempro CC with which Mr Richter was employed as a general manager.[38] In February 2013, Mr Richter brought an application, in the High court of South Africa, Gauteng Local Division, Pretoria, for an order placing Bloempro under business rescue in terms of section 131 of the Act.[39] Absa Bank Limited (Absa) opposed the application for an order to place Bloempro under business rescue.[40] Absa contended that when Mr Richter brought the application for business rescue, a final order of liquidation had already been granted against Bloempro and that it was no longer open to the court to consider an application for business rescue.[41] The court held that no application for business rescue may be brought after a final liquidation order has been granted against a company. Therefore business rescue would be impermissible as a final liquidation order has been granted against Bloempro.[42]

Mr Richter then brought an application for appeal against the judgment handed by the Gauteng High court. The appeal concerned the issue whether it is competent to apply for business rescue in terms of section 131 of the Act after a final liquidation order has been granted against a company.[43]

4.2. The issues before court

The issue before court was the interpretation of liquidation proceedings within the context of section 131(6). The court was tasked with interpreting whether the term refers only to a pending application for a liquidation order or includes the process of winding up of a company after a final liquidation order has been granted.[44]

The counsel acting for Mr Richter argued, on his behalf, that the stay of liquidation

[38] *Richter* case n 9 above 2.
[39] *Richter* case n 9 above 2.
[40] *Richter* case n 9 above 2.
[41] *Richter* case n 9 above 4.
[42] *Richter* case n 9 above 6.
[43] *Richter* case n 9 above 1.
[44] *Richter* case n 9 above 1.

proceedings as provided for in section 131(6) is applicable only in respect of a pending application for liquidation; and that once a final order of liquidation is made no application for business rescue may be brought.[45] The hub of their argument was that liquidation proceedings in section 131(6) should be interpreted in the same manner as in section 132(1)(c) in which the phrase liquidation proceedings referred to proceedings preceding a final winding up order.[46]

The counsel acting on behalf of Absa on the other hand argued that a liberal interpretation of section 131(1) may have negative results for the liquidation process.[47] The concerns raised on behalf of Absa included repetitive disruptions and uncertainty that may result from various affected parties making applications for business rescue at different times during the winding up process, reversion of business control to the same directors who may have been the cause of the financial distress experienced by the company, and the capacity of a company under final liquidation to conduct effective business, including concluding contracts, during the implementation of the rescue plan.[48]

4.3. Applicable law

The law applicable to the facts and issues before the court provide as follows:

> Section 131(1):
> *'(1) Unless a company has adopted a resolution contemplated in section 129, an affected person may apply to a court at any time for an order placing the company under supervision and commencing business rescue proceedings.'*

The section makes provision for a company to be placed under business rescue proceedings on a compulsory basis by the Court upon application by an affected person.[49] An affected person may at any time apply to court for an order placing a company under supervision and commencing business rescue proceedings.[50]

> Section 131(6):

[45] *Richter* case n 9 above 8.
[46] *Richter* case n 9 above 8.
[47] *Richter* case n 9 above 16.
[48] *Richter* case n 9 above 16.
[49] Meskin *et al Henochsberg on the Companies Act 71 of 2008* (2013) 462.
[50] Stoop n 107 below 329; see also *Sibakhulu Construction (Pty) Ltdv Wedgewood Village Golf Country Estate (Pty) Ltd* 2013 (1) SA 191 (WCC) at 6.

'(6) If liquidation proceedings have already been commenced by or against the company at the time an application is made in terms of subsection (1), the application will suspend those liquidation proceedings until-
(a) the court has adjudicated upon the application; or
(b) the business rescue proceedings end, if the court makes the order applied for.'

Section 131(6) provides that if liquidation proceedings have already been commenced by or against the company at the time an application is made in terms of subsection (1), the application will suspend those liquidation proceedings until the court has adjudicated upon the application; or the business rescue proceedings end, if the court makes the order applied for. It provides for liquidation proceedings where such application is brought at a time when liquidation proceedings have already commenced. According to Meskin,[51] an important aspect of this section is that an application for the winding-up of a company can be superseded by an application placing the company under business rescue.[52]

4.4. Judgment

4.4.1. The High Court Judgment[53]

In deciding whether it is permissible, in law, to grant business rescue procedure after the final liquidation order was granted, the court *a quo* held that business rescue proceedings and a final liquidation order are two different concepts that are incompatible and separate considerations that cannot co-exist.[54] It held that the intention of the Legislature should be considered.[55]

The court based its findings on the following reasons:

a) From the definitions of business rescue and financially distressed, sections 128(1)(b) and 128(1)(f), the legislature intended to provide for business rescue proceedings before a final liquidation order is made.[56]
b) The purpose of business rescue as defined in section 128(1)(f) refers to companies in financial distress and that the business rescue should, if not possible for the business to continue, result in a better return for creditors than would result from liquidation.[57]

[51] Meskin (n 49 (2013)) above.
[52] Meskin (n 49 (2013)) 463.
[53] 2014 6 SA 38 (GP).
[54] *Richter* case (n 53 (2014)) above 17.
[55] *Richter* case (n 53 (2014)) above 15.
[56] *Richter* case (n 53 (2014)) above 17.

c) The court granting the final liquidation order has already decided upon, and found, that the company was unable to pay its debts and that it was indeed insolvent.[58]

d) A final liquidation order has the effect of stripping a company from its original legal status and as a result the company, in itself, has no *locus standi* anymore.[59]

e) Had the legislature intended for business rescue proceedings to be instituted post liquidation, it would have clearly stated so, however, section 131(6) of the Act refers to a company under liquidation.[60]

f) If it was the intention of the legislature that a final liquidation order can be suspended by business rescue proceedings, it would mean that an interim order of business rescue may substitute the final liquidation order and this is untenable.[61]

g) Although section 132(1)(b) provides that a business rescue application can be brought during liquidation proceedings, it is remarkable that the legislature did not refer to a company already under liquidation.[62]

4.4.2. The Supreme Court of Appeal Judgment

The Supreme Court of Appeal held that section 131(1) entitles affected persons to apply to court for an order placing the company under supervision and commencing business rescue proceedings at any time.[63] It held that section 131(6) provides that if liquidation proceedings have already commenced at the time application is made for business rescue, the liquidation proceedings will be suspended. The court held further that section 131(7) also empowers the court, when considering an application for business rescue, to grant orders provided for in subsections 131(4) and (5) at any time during the course of any liquidation proceedings.

The court further held that the provisions of section 132(1) do not clearly indicate that liquidation proceedings necessarily mean those proceedings leading up to a final winding up order and nothing else. It held that liquidation is the exhaustive process by which a company is brought to an end, and the assets thereof, if any, are redistributed.[64]

According to the Supreme Court, the reasoning of the High court was motivated by an erroneous premise that upon liquidation Bloempro ceased to exist; that it was stripped of its original legal status. It held that the correct position is that upon the final order of liquidation

[57] *Richter* case (n 53 (2014)) above 18 (i).
[58] *Richter* case (n 53 (2014)) above 18 (i).
[59] *Richter* case (n 53 (2014)) above 18 (ii).
[60] *Richter* case (n 53 (2014)) above 18 (iii).
[61] *Richter* case (n 53 (2014)) above 18 (ii).
[62] *Richter* case (n 53 (2014)) above 18 (iii).
[63] *Richter* case n 9 above 9.
[64] *Richter* case n 9 above 8.

being granted the company continues to exist, but control of its affairs is transferred from the directors to the liquidator who exercises his or her authority on behalf of the company.[65]

As to when liquidation commences, the Supreme Court held that in terms of section 348 of the 1973 Act,[66] the liquidation of a company by the court is deemed to commence on presentation to the court of the application for the winding up and continues until the affairs of the company have been finally wound up and the Master's certificate to that effect is published in the Government Gazette, thus dissolving the company. It further held that section 82 of the Act provides for existence of a company until deregistered by the Commission.[67]

The court further held that indeed implementation of the Act may produce some seemingly awkward results in the initial stages. However, that does not justify an unduly restrictive approach in the interpretation of the provisions of the Act. It held that the simple answer is that a court can dismiss any application for business rescue that is not genuine and *bona fide* or which does not establish that the benefits of a successful business rescue will be achieved.[68]

There is no sensible justification, according to the court, for drawing the proverbial line in the sand between pre and post final liquidation in circumstances where the prospects of success of business rescue exist. It found that the legislature did not do so and to restrict business rescue to those cases in which a final winding up order has not been granted is contrary to the Act.[69] In conclusion, the court held that for these reasons a proper interpretation of liquidation proceedings in relation to section 131(6) of the Act must include proceedings that occur after a winding up order to liquidate the assets and account to creditors, up to deregistration of a company.[70]

4.5. Discussion of the judgment

4.5.1. The High Court Judgment

The court considered whether it is possible to grant a business rescue order after the final liquidation order has been granted. The High court held that no application for business

[65] *Richter* case n 9 above 10.
[66] Companies Act 61 of 1973.
[67] Companies and Intellectual Property Commission.
[68] *Richter* case n 9 above 16.
[69] *Richter* case n 9 above 17.
[70] *Richter* case n 9 above 18.

rescue may be brought after a final order of liquidation has been granted against a company.[71] In its findings the court held that that intention of the legislature in the wording of section 131(1) was paramount. The High Court found that business rescue proceedings and a final liquidation order are two concepts that are incompatible and separate considerations that cannot co-exist.[72] It held that the provisions of section 131(6) could not have the effect of suspending liquidation proceedings after a final liquidation order had already been obtained. It further held that the liquidation proceedings as provided for in section 131(6) of the Act did not include the administrative process as aforesaid and that an application to commence business rescue can therefore only be brought prior to the corporation being placed in final liquidation.[73]

The reasoning of the court *a quo* was that the purpose of business rescue is to place the company in a position where it is able to continue as a viable concern or alternatively, at the very least, should result in a better return for creditors than that of liquidation proceedings. However, the court granting the final liquidation order has already decided that the company is in fact insolvent and unable to pay its debts.[74] This is therefore incompatible with the definition of financial distress as defined in section 128 of the Act which clearly states that a company is financially distressed when it is likely to become insolvent or unlikely to be able to pay its debts as they become due in the near future.[75] It held that had the legislature so intended for business rescue proceeding to be instituted post liquidation, it would have clearly stated so, however section 131(6) refers also to a company under liquidation.[76]

The effect of the interpretation adopted by the High Court is that the provisions of section 131(6) do not suspend liquidation proceedings wherein a final liquidation order has been granted. The interpretation and application of section 131(6) adopted by the High Court leaves minimal opportunity for abuse by entities and affected persons who bring business rescue proceedings for the purposes of avoiding liquidation.[77] The possibility of a business rescue order in an advanced stage of winding-up is susceptible to possible abuse by affected persons whose intentions are to thwart the liquidation proceedings.[78]

It is necessary to caution against the possible abuse of the business rescue procedure, for

[71] *Richter* case (n 53 (2014)) 19.
[72] *Richter* case (n 53 (2014)) 17.
[73] *Richter* case (n 53 (2014)) 18.
[74] *Richter* case (n 53 (2014)) 18.
[75] six months.
[76] *Richter* case (n 53 (2014)) 18.
[77] See *Sulzer Pumps* case n 12 above; and *Southern Palace Investments 265* case n 28 above.
[78] Stoop n 107 below in paragraph 5 also notes that it would be naïve to imagine that desperate affected persons would not be tempted to use a business rescue application in an abusive manner and lodge the application only to frustrate liquidation.

instance, by rendering the company temporarily immune to actions by creditors so as to enable the directors of a company or other stakeholders to pursue their own ends. The legislature would not have intended to introduce a regime that would allow unscrupulous companies to use business rescue procedure to frustrate creditors.[79]

4.5.2. The Supreme Court of Appeal Judgment

The Supreme Court was required to reconsider the interpretation of liquidation proceedings as envisaged in section 131(6), the decision of the High Court and in particular whether the term only refers to a pending application for a liquidation order or whether it includes the administrative process of winding up of a company after a final liquidation order has been granted. The Supreme Court held that the meaning of liquidation proceedings must include proceedings that occur even after a winding up order has been granted.[80] It held that liquidation proceedings include liquidation prior to and after a final order of liquidation is granted. The consequence of this is that an application for the winding-up of a company can be superseded by an application placing the company under business rescue.

The court acknowledged the fact that this interpretation of liquidation proceedings can have negative results for the liquidation process generally. These include repetitive disruptions and uncertainty that may result from various affected parties making applications for business rescue at different times during the winding up process. Furthermore, it includes the reversion of the control and management of the business to the same directors who may have been the cause of the financial distress experienced by the company, and the capacity of a company under final liquidation to conduct effective business, including concluding contracts, during the implementation of the rescue plan.[81]

Unfortunately this shift and expansion of the interpretation of liquidation proceedings as provided for in section 131(6) can lead to an influx of applications by entities facing liquidation in an effort to starve liquidation and frustrate creditors. It follows thereof that this interpretation will lead to considerable abuse of the business rescue procedure. Accordingly at any stage of the liquidation proceedings, a business rescue application to court will have the effect of staying the liquidation proceedings. The consequences of this could be prejudicial to creditors. Among other things, it could result in lengthy delays to the detriment of creditors and therefore opens up the door for abuse. This is a cause for concern

[79] Stoop n 107 below 5.
[80] *Richter* case n 9 above 18.
[81] *Richter* case n 9 above 16.

especially where dishonest debtors or directors of a company can simply bring a business rescue application to court with the intention of having to avoid, interrupt or delay their own interrogation into the affairs of the company in liquidation.

If regard is had to the various purposes of the Act set out in Section 7 one finds under section 7(k) that the Act is intended 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.

Accordingly, the interests of all relevant stakeholders should be considered and balanced. Furthermore, the provisions of chapter 6 of the Act place a duty on a court to balance the sanctity of entities with the interests of creditors.[82] Such a purpose is likely to be thwarted if the application for business rescue is brought in cases where there appears to be no reasonable prospects of rescuing the company and the application is brought merely for the purposes of avoiding or delaying liquidation.[83]

Although the court was aware of the possibility of these imminent results, it held that that does not justify an unduly restrictive approach in the interpretation of the provisions of the Act.[84]

5. OVERVIEW OF THE BUSINESS RESCUE REGIME

Rushworth[85] describes the new business rescue regime as follows: 'The purpose is to facilitate the rescue and rehabilitation of a company in financial difficulty and in certain other circumstances.'

Business rescue, as defined by the Act, aims to facilitate the rehabilitation of a company that is financially distressed by providing for the temporary supervision of the company and management of its affairs, business and property by a business rescue practitioner, a temporary moratorium on the rights of claimants against the company or in respect of property in its possession, and the development and implementation, if approved, of a business rescue plan to rescue the company by restructuring its business, property, debt,

[82] *Sulzer Pumps* n 12 above 28.
[83] See *Southern Palace Investments 265* case n 28 above at 24 where the court held that it should be satisfied that business rescue will achieve more than simply prolonging the agony of a failing company.
[84] *Richter* case n 9 above 16.
[85] Rushworth "A critical analysis of the business rescue regime in the Companies Act 71 of 2008: Business rescue: Part III" (2010) *ActaJuridica*375.

affairs, other liabilities and equity.[86] One of its main objectives in terms of the provisions of section 7(k) of the Act is that provision must be made to rehabilitate companies that struggle financially in a manner that balances the rights of all stakeholders involved.[87]

The process of business rescue begins either by means of a resolution of the board of directors of the company[88] or through successful application to the High Court by an affected person.[89] There are two essential jurisdictional facts that must be established in order to achieve a successful business rescue.[90] A company may not be placed under business rescue in either of the above instances unless it is financially distressed and there is a reasonable prospect of the company being rescued.[91] A company is regarded as financially distressed if it appears 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 if it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months.[92] The purpose of the six month period is to allow companies to enter business rescue proceedings before they are actually insolvent or unable to pay their debts in the hope that timeous intervention could ensure a better success rate of rescuing companies.[93]

The term reasonable prospect is not defined in the Act. In interpreting the meaning of a reasonable prospect for the rescue of a company, the court in *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd*[94] found that this requirement was less onerous than that prescribed in the 1973 Act,[95] signaling a deliberate abandonment of the earlier limited form of corporate rescue. The court held that in terms of section 131(4) of the Act, a court may make an order placing a company under supervision and commencing business rescue proceedings if it is satisfied that the company is financially distressed; that 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

[86] s 128(1)(*b*) of the Act.
[87] s 7(*k*) of the Act and Joubert n 7 above 551.
[88] s 129 of the Act.
[89] s 131 of the Act.
[90] *Financial mail* (19-01-2015) accessed electronically 22 August 2015. http://m.news24.com/fin24/Enterpreneurs/Resources/Business-rescue-explained-20150119. (Accessed: Date 22 August 2015).
[91] s 129(1)(*a*) and (*b*); see also Joubert n 7 above 553.
[92] s 128(1)(*f*) of the Act.
[93] Business rescue should be conducted reasonably speedily. Expediency in business rescue proceedings is essential in view of the firm timeframes laid down in the Act and the negative effect that the proceedings may have on creditors' rights. See also *Koen v Wedgewood Village Golf and Country Estate* n 96 below.
[94] n 28 above 20 and 21.
[95] See s 427(1) of the 1973 Act.

reasonable prospect for rescuing the company, or, it may dismiss the application together with any further necessary and appropriate orders, including an order placing the company under liquidation. This is supported in a number of cases wherein it has been held that in order to succeed in an application, the applicant must provide cogent evidence to support the existence of a reasonable prospect that the desired business rescue objective can be achieved,[96] or alternatively that business rescue will at least yield a better return to creditors than immediate liquidation.[97]

In terms of section 128(1)(*h*) read with section 128(1)(*b*) of the Act, the objective of rescuing the company would have been achieved if the company eventually either continues in existence on a solvent basis or, if that is not possible, a better return is achieved for the company's creditors or shareholders than would have resulted from the immediate liquidation of the company.[98]

6. BRIEF DISCUSSION OF WHAT THE LIQUIDATION PROCESS ENTAILS

Liquidation is a process of administering company's affairs prior to its dissolution by ascertaining and realizing its assets and applying them firstly in the payment of creditors of a company according to their order of preference, and then by distributing the residue, if any, amongst the shareholders of the company in accordance with their rights. Generally, in law and in business, liquidation is the exhaustive process by which a company is brought to an end, and the assets thereof, if any, are redistributed.[99] The authors of *Colliers and Benade* Corporate Law[100] describe liquidation as follows:

> '…The process of dealing with or administering a company's affairs prior to its dissolution by ascertaining and realising its assets and applying them firstly in the payment of creditors of the company according to their order of preference and then by distributing the residue (if any) among the shareholders of the company in accordance with their rights, is known as the winding-up or liquidation of the company.'

[96] *Koen v Wedgewood Village Golf & Country Estate (Pty) Ltd* 2012 JOL 29024 (WCC) at 17; *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd* 2012 JOL 28598 (GSJ) at 13.
[97] *Petzetakis International Holdings* n 96 above.
[98] *Southern Palace* n 28 above 2; *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kya-lami) (Pty) Ltd; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd* 2012 3 SA 273 (GSJ) at 12.
[99] *Richter* case n 9 above 9.
[100] Cilliers *et al Corporate Law* (2000) 494.

The liquidation or winding-up of companies is dealt with and regulated based on the solvency of the company and it is governed by two legislations.[101] The winding up of solvent companies is governed by sections 79 to 81 of the 2008 Act whereas the winding-up of insolvent companies is, by virtue of the transitional arrangements in item 9 of schedule 5 to the Act, governed by the 1973 Act.[102] A solvent company may be dissolved by a voluntary winding-up initiated by the company and conducted either by the company itself or by its creditors as determined by the resolution of the company or by a winding-up and liquidation order.[103] According to the 1973 Act,[104] a company is insolvent when the company is unable to pay its debts. The power of the court to grant a winding-up order is a discretionary one, however, section 347 of the 1973 Act places restrictions on the discretionary power of the court hearing an application for winding-up.

The business rescue regime has been introduced to provide for an efficient rescue and recovery of financially distressed companies, providing viable companies with an alternative to liquidation and winging up.[105] Competing applications for liquidation and business rescue are now both running the litigation race and vying for a win.[106]

7. LIQUIDATION PROCEEDINGS IN THE CONTEXT OF SECTION 131(6)

The Act does not define the concept of liquidation proceedings[107] and the interpretation thereof is an issue our courts have been battling with. Our Courts are enjoined to interpret statutes purposively.[108] The wording of the provisions of section 131(6) is problematic due to the legislature not having followedthe wording of sections 348 and 358 of the 1973 Act where a clear distinction is made between the commencement of winding up by the court, which refers to the start of the process until the dissolution of the company; and legal proceedings, referring to court proceedings.[109] The crux of the issue is whether the term

[101] Boraine & Van Wyk "The application of "repealed" sections of the Companies Act 61 of 1973 to liquidation proceedings of insolvent companies" 2013 *De Jure* 646; see also *Firstrand Bank Ltd v Wayrail Investments (Pty) Ltd* (684/2012) [2012] ZAKZDHC 91; [2013] 2 All SA 295 (KZD) (20 December 2012) at 9 and *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd*(936/12) [2013] ZASCA 173 (28 November 2013) at 9.

[102] Cassim *et al Contemporary Company Law (*2nd ed) 913.

[103] Cassim n 102 above 914; see also s 79 (1) read with s 80 (1) of the Act.

[104] s 345 of the 1973 Companies Act.

[105] See *Van Niekerk v Seriso 321 CC* (952/11) and (23929/11) 2012 ZAWCHC 63 (20 March 2012) (WCC) wherein the court held that business rescue was introduced as the preferred alternative to winding-up because it is in the public interest to salvage businesses rather than liquidate them.

[106] Wassman "Business rescue: getting it right." 2014 Jan/Feb *De Rebus* 36.http://www.saflii.org/za/journals/DEREBUS/2014/4.html (Accessed: Date 22 August 2015).

[107] Stoop "When does an application for business rescue proceedings suspend liquidation proceedings?" 2014 (2) *De Jure* 329.

[108] *Investigating Directorate: Serious Economic Offences and Others v Hyundai Motor Distributors (Pty) Ltd and Others* 2001 (1) SA 545 (CC) at 22 – 24.

[109] Loubser S*ome comparative aspects of corporate rescue in South African company law* (2010

liquidation proceedings refers only to a pending application for a liquidation order or includes the process of winding up of a company after a final liquidation order has been granted. In the context of financial markets, insolvency proceedings are defined in section 1 of the Financial Markets Act[110] as judicial or administrative proceedings or both, authorised in or by national legislation or the laws of a country, including an interim proceeding.

In *Richter,*[111] the Supreme Court held that the interpretation of liquidation proceedings includes liquidation prior to and after a final order of liquidation is granted up until deregistration.[112] However, the High Court held that had it been the legislature's intention, the legislature would have clearly stated that section 131(6) refers to a company under liquidation. It further held that a final liquidation order strips a company of its status. The court *a quo* found that although there is no definition in the Companies Act of what precisely liquidation proceedings entail, the section does apparently not include a liquidated company.[113] The reasoning followed by the Supreme Court was that the court *a quo* erroneously found that upon the final liquidation, the company ceased to exist.[114] The Supreme court found that upon the final liquidation of a corporation it continues to exist, notwithstanding the fact that the control of its affairs are transferred from the directors to the liquidator who exercises his or her authority on behalf of the corporation.[115]

The court in *Van Standen v Angel Ozone Products CC*[116] held that although a distinction could be made between the legal proceedings before a court and winding-up proceedings overseen by the liquidators, these are not separate proceedings. Winding-up is a continuation of liquidation proceedings. Liquidation proceedings come to an end only when the final liquidation and distribution account is confirmed.[117] If business rescue is a better alternative than winding-up, it does not matter how far the winding-up has progressed.[118]

In *FirstRand Bank Limited v Imperial Crown Trading 143 (Pty) Ltd*[119] it was held that liquidation proceedings in section 131(6) only relate to the actual process of winding and excludes the legal proceedings and/or substantive application and/or steps taken by a

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thesis SA) 79.http://uir.unisa.ac.za/bitstream/handle/10500/3575/dissertation_loubser_a.pdf (Accessed: Date 22 September 2015).

[110] Act 19 of 2012.
[111] *Richter* case n 9 above.
[112] *Richter* case n 9 above 18.
[113] *Richter* case (n 53 (2014)) above 18 (iii).
[114] *Richter* case n 9 above 10.
[115] *Richter* case n 9 above 10.
[116] 2013 4 SA 630 (GNP) at 27.
[117] *Van Standen* case n 116 above at 25.
[118] *Van Standen* case n 116 above at 30; see also Meskin n 49 above 471.
[119] 2012 4 SA 266 (KZD) at 20 and 21.

creditor to obtain a winding-up order.[120] Therefore, only the implementation of the final winding-up order is suspended and not the order itself.[121]

In reliance to the *Imperial Crown Trading*[122] case, the court in *Absa Bank Ltd v Summer Lodge (Pty) Ltd*[123] held that liquidation proceedings refer to a process that consists of the collection of the assets, realising and reducing them to money, dealing with proof of creditors by admitting or rejecting them, and distributing the net proceeds after providing for costs and expenses by the liquidator to the persons entitled thereto. Thus, the words liquidation proceedings have to do with the process that is overseen by the liquidator and the master in winding-up and not the legal proceedings before a court of law in order to obtain such order.[124] The court further held that what section 131(6) means is that once liquidation proceedings have commenced by the granting of a liquidation order, whether provisional or final, the mere issue and service of a business rescue application would suspend the liquidation process.[125] Therefore an application for business recue as referred to in section 131(6) would only suspend liquidation proceedings if a provisional or final order had previously been granted.[126] In paragraph 19, the court emphasised that it was not the intention of the section to discharge or set aside a liquidation order but merely to suspend the order so as to delay the implementation thereof. The court based its reasoning on section 348 of the 1973 Act which provides that in the granting of a winding-up order, the winding-up of a company shall be deemed to commence at the presentation to the court of the application for the winding-up and if no such order has been granted any liquidation proceedings cannot be deemed to have commenced. According to the court this differentiated between the application and the proceedings.[127]

On the other hand, the court in *Van Zyl v Engelbrecht NO*[128] held that the suspension of liquidation proceedings entails the suspension of the office of the liquidator and no collection of, *inter alia*; assets by the liquidator can take place during business rescue. It held further that any steps taken by a liquidator in liquidation proceedings after an application for business rescue has been made are futile and of no legal consequence; although such steps may be ratified by the liquidator at the end of the suspension period contemplated by section 131(6)(a) and (b) of the Act, or possibly by the appointed business rescue

[120] See also *Absa Bank Ltd v Summer Lodge (Pty) Ltd* 2014 3 SA 90 (GP).
[121] See also *Absa Bank Ltd v Makuna Farm CC* 2014 3 SA 86 (GJ) at 8; and *Absa Bank Limited v Cardio Fitness Properties* (2012/2008) 2013 ZAGPJHC (28 November 2013) at 10.
[122] *Imperial Crown Trading* case n 119 above.
[123] *Summer Lodge* case n 120 above.
[124] *Summer Lodge* case n 120 above at 12.
[125] *Summer Lodge* case n 120 above at 18.
[126] Stoop n 107 above 3.
[127] See also *Makuna Farms* case n 121 above at 10.
[128] 2014 5 SA 312 (FB) at 14.

practitioner where liquidation proceedings are converted into business rescue proceedings.[129] On a contrary view, the court in *Janse van Rensburg NO and another v Cardio Fitness Properties (Pty) Ltd and others*[130] held that the suspension of liquidation proceedings will not divest the liquidator of control over the assets of the company.[131]

In *Absa Bank Limited v Makuna Farm CC*[132] the court held that the pivotal question for determination is whether the words liquidation proceedings as they appear in section 131(6) of the Act is a reference to the substantive application taken by creditor to obtain a winding up order, or to the liquidation proceedings and processes that follow the granting of such an order. If the reference in the section is to the application proceedings to obtain a winding up order, then clearly the suspension envisaged therein would apply to the grant of a final winding up order. The court held further that the words liquidation proceedings in section 131(6) refer to the proceedings that follow the grant of a winding up order, and not to the application to obtain a winding up order.[133]

It is evident from the above court decisions that our courts have grappled with the meaning of liquidation proceedings and have as a result reached different conclusions. The majority of the courts seem to have accepted that an application for business rescue will serve to suspend liquidation proceedings even after a final liquidation order has already been granted.[134] It then follows from the above decisions that applications for business rescue can be brought at a very late stage or even years after the liquidation application as a reaction to a provisional or final winding-up order resulting in the suspension of the proceedings.[135] The effects thereof lend itself to abuse.

As it can be seen from various cases dealing with business rescue applications, our courts have demonstrated a willingness to engage the new business rescue procedure;[136] however, it appears that the provisions of the Act are posing some challenging interpretational problems. Where a court is tasked with a duty to determine whether liquidation proceedings as referred to in section 131(6) include the winding-up process or adjudicating a business

[129] *Van Zyl* case n 128 above at 15.
[130] 2014 JOL 31979 (GSJ).
[131] See *Blue Star Holdings (Pty) Ltd v West Coast Oyster Growers CC* 2013 (6) SA 540 (WCC) at 36 where the application for winding-up was suspended.
[132] *Makuna Farms* case n 121 above 6.
[133] *Makuna Farms* case n 121 above 7; see also *Absa Bank Limited v Earthquake Investments (Pty) Limited* (unreported Case No 2012/63190), where the court expressed a similar view.
[134] Stoop n 107 above 4.
[135] See *the Commissioner for the South African Revenue Service v Beginsel and others* WCHC case number: 15080/12 (31 October 2012) were the court held that because business rescue proceedings were well advanced, it would not be a good idea to convert them into a winding-up.
[136] A clear preference for business rescue was demonstrated in *the Commissioner for the South African Revenue Service v Beginsel and others* n 135 above.

rescue application wherein there is a provisional or final liquidation or winding-up order, the courts should consider the merits of the case and also evaluate the underlying purpose of the business rescue application.[137] If business rescue is able to achieve a broader purpose than that which is determined by a literal meaning of the term, courts ought to allow that purpose in so far as it aligns with the purposes of the Act and equitably balances the interests of the relevant stakeholders.[138]

8. THE PRACTICAL CONSEQUENCES OF THE *RICHTER* JUDGEMENT

The effect of the business rescue application when one considers the provisions of section 131(6) of the Act is that the liquidation proceedings as commenced, stand to be suspended until the business rescue application is adjudicated upon, alternatively, until the business rescue proceedings come to an end due to the court granting the order sought by the fourth respondent. The consequence of the Supreme Court's interpretation of liquidation proceedings in *Richter*[139] is the fact that an affected person can apply for business rescue at any time, whether a winding-up order has been granted or not. It follows that the application for business rescue can be lodged at any time up to deregistration of a company.[140] If this interpretation is followed, then a company in the process of being wound up can still be placed under business rescue thereby suspending the liquidation process.[141] The consequence thereof is that even if the administration of the liquidation process by the liquidator is far advanced and has been going on for a period of time, a company can still be placed under business rescue and the liquidation process be suspended.[142] This will be good in a case wherein a company is resurrected and restored to business.

The stance taken by the court *a quo* in *Richter*[143] seems to be plausible. If an application for business rescue is permissible after a final liquidation order has been granted, further problems like what should eventually happen to the final liquidation order and the appointment of the liquidators arise.

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[137] It would be desirable if a good business can be revived through business rescue and the objects of the process, which is *inter alia* to rescue and rehabilitate a financially distressed company, be satisfied.

[138] Bradstreet "Business rescue proves to be creditor-friendly: C J Claassen J's analysis of the new business rescue procedure in *Oakdene Square Properties"* 2013 *SALJ* 44.

[139] *Richter* case n 9 above.

[140] *Richter* case n 9 above 18; see also *Van der Merwe v Zonnekus Mansion (Pty) Ltd* (in liquidation) (4653/2015) [2015] WCC (10 June 2015) where the judge disagreed with the decision taken by the Supreme Court of Appeal *Richter* n 9 above, but was bound by it.

[141] Braatvedt "unscrambling the liquidation egg" 2013 April *Without Prejudice* 36.

[142] Meskin n 49 above 478.

[143] *Richter* case (n 53 (2014)) above 18 (vi).

In *Absa Bank Limited v Makuna Farm CC*[144] the court held that the launch of business rescue proceedings does not alter the legal status of the company in liquidation but merely stays the implementation of the winding up order. The manifest purpose of the section 131 (6) suspension is to delay implementation of the winding up order pending the outcome of the business rescue application, but the company remains under winding up, whether finally or provisionally. Support for this view is to be found in the judgment of *Absa Bank Limited v Summer Lodge (Pty) Limited*[145] where the court emphasised that it is not the intention of the section to render a liquidation order to be set aside or to be discharged by the issue of a business rescue application in terms of section 131(6), but to rather suspend the order so as to delay the implementation of the order, and it can also not have the effect that the company can proceed carrying on business. The company remains to be finally or provisionally liquidated, as the case may be, until such time as the business rescue proceedings have been finalized.[146]

The Supreme court in *Richter* held that in terms section 136(4) of the Act, if liquidation proceedings have been converted into business rescue proceedings, the liquidator is regarded as a creditor of the company to the extent of any outstanding amounts owing to him or her for any remuneration due for work performed, or compensation for expenses incurred before the commencement of business rescue proceedings.[147] The court did not deal with an instance where business rescue proceedings do not succeed, as to whether the business rescue practitioner will be regarded as a creditor of the company as it had pronounced in the case where the business rescue proceedings succeed.[148] However, in *Cardinet (Proprietary) Limited v Wedgewood Golf and Country Estates (Pty) Ltd (in liquidation)*[149] the court ordered the applicant to indemnify the joint liquidators in respect of their reasonable fees and expenses incurred in the winding-up of Wedgewood.

Another question that arises is the effect of the judgment on the powers of the liquidators and the work that the liquidators have already done. What is to be done with the work done by the liquidators and how is it to be undone.[150] Section 131(6) of the Act also does not pronounce on its effect on the powers of the liquidators. In *Janse van Rensburg NO and another v Cardio Fitness Properties (Pty) Ltd and others,*[151] the court held that the

[144] *Makuna Farms* case n 121 above 8.
[145] *Summer Lodge* case n 120 above at 19.
[146] See also *Eveleigh v Dowmont Snacks (Pty) Ltd and others* 2014 JOL 31954 (KZP) at 13–14 where the court agreed with these views.
[147] *Richter* case n 9 above 12.
[148] This will possibly give rise to more litigation.
[149] WCC Case no 19599/2012.
[150] Braatvedt n 141 above 37.
[151] n 130 above at 52.

suspension of liquidation proceedings will not divest the liquidator of control over the assets of the company.[152] The court held that had it been the intention of the legislature that provisional liquidators should be relieved of control before the appointment of a business rescue practitioner; the legislature would have states clearly and unambiguously.[153]

The stance adopted by the court in *Janse van Rensburg NO*[154] is incoherent with the court's findings in *Van Zyl v Engelbrecht NO.*[155] In this case the court held that the suspension of liquidation proceedings entails the suspension of the office of the liquidator and no collection of, *inter alia*; assets by the liquidator can take place during business rescue. The fact that the liquidators might be left unable to act and the delays and costs of abusive litigation might be detrimental.[156]

In terms of section 132(2) of the Act business rescue proceedings end when the court sets aside the resolution or order that commences the proceedings or the conversion by the court of the business rescue proceedings to liquidation proceedings. Another question that arises is if the business rescue proceedings are not converted into liquidation proceedings by the court, when is the liquidation in terms of section 348 of the 1973 Act deemed to commence.[157] What becomes of the winding up proceedings already instituted but suspended by reason of the subsequent application for business rescue? Unfortunately the provisions of chapter 6 are silent in this regard. If the business rescue practitioner concludes that there is no chance for the company to be rehabilitated, then the practitioner must inform the court, the company and all affected persons and apply to the court for an order to discontinue the business rescue proceedings and to place the company into liquidation.[158]

In discussing the effects of its decision, the Supreme Court in *Richter*[159] formed the view that it would be fairly easy to imagine instances, after the issue of a final winding-up order, which could lead to circumstances where the company improves drastically, to the point where it would become profitable, should it be allowed to trade. Some academics[160] are of the view that the judgment has both positive and negative effects. The positive would be if business

[152] See *Blue Star Holdings (Pty) Ltd v West Coast Oyster Growers CC* 2013 (6) SA 540 (WCC) at 36 where the application for winding-up was suspended.
[153] *Janse van Rensburg* case n 130 above at 52.
[154] n 130 above.
[155] n 128 above at 14.
[156] The court in *Absa Bank Ltd v Newcity Group (Pty) Ltd, Cohen v Newcity Group (Pty) Ltd and another* 2013 3 ALL SA 146 (GSJ) also cautioned against the possibility of claim for damages and the risk of litigation.
[157] See *Sibakhulu Construction* case n 50 above at 24.
[158] s 141(2)(*a*) of the Act.
[159] *Richter* case n 9 above 15.
[160] Braatvedt n 141 above 37; see also Bouwer "Launching business rescue applications in liquidation proceedings – (successfully) fogging a dead horse?"2015 September *De Rebus* 51.

rescue becomes a success and the business is resurrected after having been effectively rendered incapable, and the negative effect would be the lodging of business rescue applications years after the liquidation of a company resulting in tremendous difficulties for the liquidators and the work done in the course of the process.[161] In addition the negative effect of the judgment is the fact that the expansion of the meaning of liquidation proceedings to include winding-up up to deregistration of a company opens the process up to abuse.

9. ABUSE OF THE BUSINESS RESCUE PROCEDURE AND THE PROVISIONS OF SECTION 131(6)

The business rescue procedure encapsulated in Chapter 6 of the Act has been designed to prevent the demise, through winding-up, of viable companies by making provision for their possible rescue.[162] The business rescue process is intended for genuine attempts to achieve the aims of the Act and caution must be exercised against the abuse of the process.[163] Although business rescue may be a good tool for the purpose of turning around financially distressed businesses, it also opens the door for abuse by unscrupulous persons.

Owing to the relief afforded by section 131(6) of the Act, allowing a business rescue application at any stage of liquidation proceedings, the process is prone to abuse by companies and affected persons to serve ulterior purposes. An application for business rescue can be brought merely for the purpose of delaying or suspending existing liquidation proceedings.[164] The courts have been grappling with the abuse of the business rescue system, where some companies have simply been looking for a debt holiday. The risk of abuse or manipulation of the business rescue application process is one of the factors a court has to take into consideration.The courts ought to be careful not to allow the procedure to be used where there appears to be an ulterior purpose behind the business rescue application.[165] It is necessary that an application for business rescue be carefully scrutinised so as to ensure that it entails a genuine attempt to achieve the aims of the statutory remedy.[166]

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[161] Braatvedt n 141 above 37.
[162] Meskin *et al Insolvency Law* (2013) at 18.1. http://0-www.mylexisnexis.co.za.ujlink.uj.ac.za/Index.aspx (Accessed: Date 28 August 2015).
[163] *Southern Palace Investments 265* case n 28 above at 3.
[164] The abuse of the business rescue procedure was very evident in the case of *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* (609/2012) 2013 ZASCA 68 (27 May 2013).
[165] Anderson "Viewing the proposed South African business rescue provisions from an Australian perspective" 2008 (1) *Griffiths Business School Journal* at 8.
[166] *Southern Palace Investments 265* case n 28 above at 3.

The abuse of business rescue and the relief provided for in section 131(6) of the Act is evident in *Absa Bank Ltd v Newcity Group (Pty) Ltd*[167] where the sole shareholder and director of Newcity lodged a business rescue application in order to suspend the provisional winding-up proceedings, but later withdrew the application and admitted that it was a strategy to buy time and delay liquidation. The court held that the business rescue application brought by the applicant should be branded as an abuse and manipulation of the business rescue procedure. The court found that it was clear from the timing of the business rescue application that its sole objective was to paralyse the liquidation application.

In the case of *Sulzer Pumps (South Africa) (Pty) Limited v O & M Engineering CC,*[168] some months after the filing of an application for provisional winding up by the applicant, the respondent applied for business rescue. The court held that a business rescue application must be brought at the first available opportunity and must not be brought as a knee-jerk reaction to an application for liquidation as was done in this case.[169] The Court was convinced that the business rescue application was brought to thwart the liquidation application.[170] It found that all the defences raised by the respondent were spurious, did not set up a real dispute of fact and were rejected.[171] A provisional order for liquidation was in turn granted.

In the case of *Swart v Beagles Run Investments 25 (Pty) Ltd and Others*[172] the creditors opposed the application for business rescue on the grounds that the application was in itself an abuse of process and a culmination of a number of attempts to avoid and postpone payment of the respondent's debts. The court agreed[173] and held that there was no prospect of the company carrying on business on a solvent basis. It found that the applicant had not made out a case that creditors will be better off in business rescue than in liquidation.[174]

In the case of Gormley *v West City Precinct Properties (Pty) Ltd (Anglo Irish Bank Corporation Ltd intervening); Anglo Irish Bank Corporation Ltd v West City Precinct Properties (Pty) Ltd*[175] the court was not prepared to give the developers any leeway without a *bona fide* workable restructuring plan, given that rescue proceedings could lend

[167] *New city* case n 6 above.
[168] n 12 above.
[169] *Sulzer Pumps* case n 12 above 24.
[170] *Sulzer Pumps* case n 12 above 28 and 29.
[171] *Sulzer Pumps* case n 12 above 31.
[172] 2011 5 SA 422 (GNP).
[173] *Swart* case n 172 above 27.
[174] *Swart* case n 172 above 42.
[175] 2012 ZAWCHC 33 (WCC).

themselves to abuse by company insiders seeking to use these provisions to frustrate creditors' rights and to stave off liquidation for motives of their own. The court held that using business rescue for the sole purpose of obtaining a moratorium is insufficient as that would allow abuse of the business rescue process in order to frustrate the rights of creditors and stave liquidation.[176]

From above court decisions, it has become apparent that the courts are not allowing frivolous applications to succeed and, as a result, are setting the standard or benchmark to succeed with rescue proceedings on grounds that are material, factual and objective. The *Oakdene*[177] case raised the important question about where the division lies between use and abuse of the procedure. The court found that there was no business of the company to be rescued, nor any benefit in saving the company.[178] The court found that the interests of the creditors as opposed to that of the company should carry more weight in the circumstances of this case. The court ruled that business rescue was not intended to achieve a winding-up of a company to avoid the consequences of liquidation proceedings.[179]

In a very concerning decision, the court in *Cardinet (Pty) Ltd v Wedgewood Golf and Country Estate (Pty) Ltd (In Liquidation) and Others*[180] granted a business rescue application in respect of a company that had already been finally wound-up by the same Court after two previous unsuccessful business rescue applications, and which had been in liquidation for almost a year. The Court did not consider the fact that the company was already in liquidation to be an issue, as no reference is made to either section 131(6) and/or (7) of the Act. This is exactly what the court *a quo* in *Richter* argued against.[181] While this case confirms that a company may be placed under business rescue no matter how far advanced the liquidation process has proceeded, the consequences that follow are that this decision can be used as a basis for applications to resuscitate companies that have already been placed in liquidation, and which may amount to an abuse of process.[182]

10. PROTECTION OF THE RIGHTS OF CREDITORS

South African insolvency law has traditionally been classified as a pro-creditor system, mostly due to the fact that our insolvency law exists primarily for the benefit and protection of

[176] *Gormley* case n 175 above 15.
[177] n 164 above.
[178] *Oakdene* case n 164 above 39.
[179] *Oakdene* case n 164 above 33.
[180] *Cardinet* case n 149 above.
[181] Para 4.4.1 above.
[182] Meskin *Insolvency law* (n 162 (2013)) above at 18.4.3.

creditors.[183] Although the primary objective of business rescue is so assist ailing companies, its alternative objective is to see better return for creditors. Section 128(1)(b) of the Act emphasises that business rescue should have the likely result of the company being able to continue as a viable concern or alternatively at least that it should result in a better return for creditors than it would occur if the company were to be liquidated. Section 7(k) also emphasizes the balance of the rights of all stakeholders.The definition of business rescue in Section 128(1)(b)(iii) recognises both the creditors' and shareholders' interest in rescuing a business in such an instance where there is also a reasonable prospect of the company's recovery.[184] The business rescue process has been set up to make an effort to involve all the affected parties and through the appropriate planning seeks to ensure that all the affected parties are satisfied with the conditions and actions that will be set and taken.

The difficulty that arises is that the interpretation of liquidation proceedings to include winding-up proceedings until deregistration of a company has the effect that the court would be able to convert liquidation proceedings into business rescue proceedings regardless how far the liquidation and winding-up proceedings might have progressed. This has the effect of prejudicing creditors. If the business rescue application fails, the applicants would continue with their liquidation process. Should it succeed, then the appointed rescue practitioner would take over as that decision would have confirmed, *ex lege*, the suspension of the liquidators from continuing with the liquidation process.[185] According to Stoop,[186] should the mere lodging of and servicing of the application suspend liquidation proceedings *ex lege*, the consequences would be that the assets would revert to the initial managers which could have an extensive and potentially devastating impact of the rights of creditors.

Although some academics are of the view that the law has moved from a creditor-friendly approach,[187] it is apparent that the legislature had the rights of creditors in mind when it introduced the provisions of section 129(2)(a) which provides that a company may not voluntarily initiate business rescue proceedings by means of a company resolution after liquidation proceedings have been commenced.A significant protection afforded to creditors is to challenge a resolution adopted by the company's board of directors. In terms of section 130(1) of the Act, an affected person may oppose a company resolution to initiate business rescue proceedings and may apply to court for an order setting aside the resolution on the grounds that there is no reasonable basis to believe that the company is financially

[183] See sections 6(1) and 12(1)(*c*) of the Insolvency Act 24 of 1936 which provides that an "advantage for creditors" that has to be proved before a court will grant a sequestration order.
[184] Bradstreet (n 20 (2011)) 356.
[185] *Janse van Rensburg* case n 130 above at 9.
[186] Stoop n 107 above 5.
[187] Bradstreet (n 20 (2011)) 354.

distressed, or that there is no reasonable prospect that the company will be rescued, or the company has failed to comply with the procedural requirements set out in section 129. Furthermore, creditors, being affected persons, have a right to participate in the hearing of an application for business rescue.[188] The business rescue process provides a more transparent system in the planning and implementation of the procedure.

In the case of *Swart*,[189] as to the alternative object of ensuring a better return to creditors, the court found that Swart had not made out a case that the creditors will be better off in business rescue than in liquidation. The only person interested in the continuation of the company was Swart, whose interests coincide with those of the company. The interests of the creditors weighed heavier[190] and the court dismissed the application for business rescue. The case of *Oakdene*[191] also gives reassurance to creditors that their interests, although no longer of paramount importance, are afforded protection by the very definition of what business rescue seeks to achieve. The court confirmed an interpretation of the meaning of business rescue that embraces the protection of creditors.[192] In the light of the circumstances of the case, particularly the fact that there was no business of the company to be rescued, nor any benefit in saving the company, the court found that the interests of the creditors as opposed to that of the company should carry more weight in the circumstances of this case.[193]

It is evident from the above provisions and case law that creditors, whose interests are protected by the secondary object of business rescue as defined in Chapter 6 seem to be placed on equal footing to the company itself when this does not defeat the primary object of the rescue procedure.[194] It is however debatable whether the costly and time-consuming remedy of obtaining an order of court will prove to be a very effective weapon against abuse of the proceedings.[195] Even so, making it too easy to reverse a board's decisions will undoubtedly undermine the success of the business rescue proceedings, however in certain instances it helps in intercepting abuse of the process. According to Loubser,[196] the potential abuse of the procedure is an unavoidable risk that must be taken in order to encourage

[188] s 131(3) of the Act.
[189] *Swart* case n 172 above at 42.
[190] *Swart* case n 172 above at 41.
[191] n 164 above.
[192] Bradstreet "Lending a helping hand: The role of creditors in business rescues?" 2013 *De Rebus*.http://www.saflii.org/za/journals/DEREBUS/2013/234.pdf (Accessed: Date 23 October 2015).
[193] *Oakdene* case n 164 above 49.7; see also in this regard Bradstreet n 192 (2013) above 47.
[194] Bradstreet (n 20 (2011)) 378.
[195] Loubser "The business rescue proceedings in the Companies Act of 2008: concerns and questions (Part 1) 2010 TSAR 505.
[196] Loubser (n 109 (2010)) at 69.

boards to initiate business rescue proceedings where and when necessary. Steiner[197] in discussing the corporate rescue procedures in England stated that it was almost impossible to reconcile the desire for a relatively cheap and straightforward moratorium regime, with the need to prevent unscrupulous company directors from abusing the procedure.

11. HOW DOES THE CONCEPT OF *CONCURSUS CREDITORUM* FIT IN WITHIN THE CONCEPT OF BUSINESS RESCUE?

The concept of *concursus creditorum* is regarded as one of the key concepts of the South African law of insolvency.[198] *Concursus creditorum* entails that the interests of the creditors as a group enjoy preference over the interests of individual creditors. The court in *Walker v Syfret*[199] explained the key concept of *concursus creditorum* as follows:

> 'The object of the Insolvent Ordinance is to ensure a due distribution of assets among creditors in the order of their preference. And with this object all the debtor's rights are vested in the Master or the trustee from the moment insolvency commences. The sequestration order crystallises the insolvent's position; the hand of the law is laid upon the estate, and at once the rights of the general body of creditors have to be taken into consideration. No transaction can thereafter be entered into with regard to estate matters by a single creditor to the prejudice of the general body. The claim of each creditor must be dealt with as it existed at the issue of the order.'

Insolvency law proceeds from the premise that once a sequestration order is granted, a *concursus creditorum* comes into being. Section 361(1) of the 1973 Act provides that in the event of a winding-up by the court all the property of the company concerned shall be deemed to be in the custody and under the control of the Master until a provisional liquidator has been appointed and has assumed office.[200] The interpretation adopted by the court in *Richter* and others,[201] that business rescue proceedings would suspend liquidation proceedings including winding up proceedings even in instances wherein a final wounding up order has been granted, will border on this underlying principle of insolvency law. Unlike in liquidation and sequestration, business rescue provisions do not provide for *concursus creditorum*. In terms of section 131(6) of the Act the liquidation proceedings will be suspended until the business rescue application has been refused or if granted, when business rescue proceedings end.

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[197] Steiner "The Insolvency Bill 2000: rescue cultural in the new millennium" (2000) 15 *Journal for International Banking Law* at 62.
[198] Boraine & Calitz "Some consequences of the National Credit Act 34 of 2005 on the proof of claims in Insolvency Law" 2010 TSAR 797.
[199] 1911 AD 141 at 166.
[200] *Muller NO & another v Community Medical Aid Scheme* (901/2010) [2011] ZASCA 228.
[201] *Van Standen* case n 116 above*; Summer Lodge* case n 120 above.

It appears as if the legislature and our courts have forgotten to assess the impact that the current position of business rescue regime might have on the principle of *concursus creditorum.* The effect of business rescue is that, in terms of section 133, there is a moratorium against the institution of legal proceedings, including enforcement action against the company, or in relation to any property belonging to the company or lawfully in its position. Where a company is placed under business rescue, a moratorium will apply in respect of all legal proceedings instituted against it until such time as the business rescue proceedings are concluded.[202] Thus, creditors are precluded from seeking to enforce claims against a company under business rescue without obtaining leave to do so from the business rescue practitioner or a court of competent jurisdiction.[203] The regime is designed to provide the company with breathing space while the business rescue practitioner attempts to rescue the company by formulating and implementing a business rescue plan.[204]

Business rescue is not equivalent to an insolvency regime following a *concursus creditorium* and therefore, the prohibition against set-off does not apply during business rescue.[205] The moratorium may be lifted, as envisaged in section 133(1)(a) of the Act, and proceedings may still be launched with a set-off against a claim made by the company in any legal proceedings before or after the start of the business rescue proceedings.[206] According to Stoop,[207] once the hand of the law is laid upon the estate, surely a mere application should not be able to dislodge it. Conversely, according to Meskin,[208] this is a crucial element of any corporate rescue mechanism, as it allows the company sufficient breathing space to be able to find a solution to the financial problems it is experiencing at that time.

12. CONCLUSION

The business rescue regime is a new system on the company law block which has been integrated into our law with the intention of improving the prospects of reviving a distressed company to the general benefit of stakeholders and the economy. The business rescue regime has addressed a number of the pitfalls of judicial management and offers a more

[202] s 133(1) of the Act.
[203] Krige “Frustrating the vultures' lunch: company law” 2013 December *Without Prejudice* 20.
[204] Meskin n 49 above at 478.
[205] Kats “A practical guide to the implications of the new Companies Act (9) - practical implications of the new business rescue regime in terms of chapter 6 of the new Act” 2010 November *De Rebus* 53.
[206] Huÿssteen, HL (2012) An overview of the business rescue moratorium contained in section 133 of the Companies Act 71 of 2008 LLM (Commercial Law) [Unpublished]: University of Johannesburg. Retrieved from: https://ujdigispace.uj.ac.za (Accessed: Date 22 October 2015).
[207] Stoop n 107 above 338.
[208] Meskin n 49 above at 478.

comprehensive methodology in terms of rescuing companies.[209] However, there are still a lot of grey areas and/or *lacunae* which the courts are still to help ascertain or eradicate by interpreting the law.[210]

Business rescue proceedings are intended to assist a company in financial distress to restructure its operations with a view to making it financially viable for the benefit of creditors and shareholders, as an alternative to liquidation. An important question, which then arises is the interplay between business rescue proceedings and liquidation proceedings, as many business rescue cases have involved applications to court for liquidation by the financially distressed company's creditors and countered by applications for business rescue by other affected persons, most notably, the company's directors and/or shareholders.[211]

One of the most important prerequisites for commencement of business rescue proceedings, in terms of section 131 of the Act, is that there is a reasonable prospect of rescuing the company.[212] While some of these applications to place companies under business rescue are motivated by genuine beliefs that there are reasonable prospects of rescuing and resuscitating the company, in some instances many of our courts have expressed more sceptical views in this regard, speculating that the only motive of the directors is to avoid liquidation and frustrate creditors.[213] The responsibility lies with the courts to analyse and deduce from the grounds provided whether the application is brought as a genuine attempt to achieve the goals of business rescue or with the ulterior motive of avoiding liquidation.

The courts must be careful in the balancing exercise to give proper weight and consideration to the various competing interests and to guard against the use of business rescue proceedings in situations where it is clearly not warranted.[214] In *Anthonie Welman v Marcelle Props 193 CC and Others*[215] the court cautioned in this regard as follows:

> 'In my view business rescue proceedings are not for the terminally ill close corporations. Nor are they for the chronically ill. They are for ailing corporations which, given time, will be rescued and become solvent. To grant the present

[209] Museta *The Development of Business Rescue in South African Law* (2011 thesis SA) 47. http://repository.up.ac.za/bitstream/handle/2263/27867/dissertation.pdf?sequence=1 (Accessed: Date 25 October 2015).
[210] *Janse van Rensburg* case n 130 above at 6.
[211] Krige n 203 above 20.
[212] See also s 129(1)(*b*) of the Act.
[213] As well as potential personal liability for the company's debts under s 424 of the 1973 Act if there is evidence of reckless trading.
[214] *Employees of Solar Spectrum Trading 83 (Pty) Limited v AFGRI Operations Limited and Another, In Re; AFGRI Operations Limited v Solar Spectrum Trading 83 (Pty) Ltd* (6418/2011, 18624/2011, 66226/201, 666226/2011, 66226A/11) [2012] ZAGPPHC 359 (16 May 2012) at 11.
[215] 33958/2011 (GSP).

> application, in these circumstances, would be to subvert the purposes of the Act and disregard the interest of other stakeholders.'

An application for business rescue may be made even after liquidation proceedings have been commenced by or against the company, and this will have the effect of suspending the liquidation proceedings until the court has refused the application for business rescue or, if the application is granted, until the business rescue proceedings have ended.[216] The whole business rescue application balances on the court's discretion and it is ultimately within the court's discretion to dismiss an application for business rescue when it suspects that it is illegitimate and ill-founded.[217] As matters currently stand, there is uncertainty in the law and procedures insofar as the definition of liquidation proceedings is concerned. At issue is whether it is competent to apply for business rescue in terms of section 131 after a final liquidation order has been granted against a company; and whether the term liquidation proceedings as envisaged in section 131(6) refers only to a pending application for a liquidation order or includes the process of winding up of a company after a final liquidation order has been granted.

The case of *Richter*[218] dealt with such a *lacunae*, as the Act does not address what liquidation proceedings as contemplated in section 131(6) entail.The courts have provided conflicting answers to the question. The court *a quo* held that it was not competent to apply for business rescue after the issue of a final winding order.[219] However, the Supreme court of appeal overturned the court *a quo*'s decision and held that a proper interpretation of 'liquidation proceedings' in relation to section 131(6) of the Act must include proceedings that occur after a winding up order to liquidate the assets and account to creditors, up to deregistration of a company.[220] Depending on which side of the fact, it is arguable that the approach adopted by the Supreme Court Appeal in *Richter*[221] could be quite disruptive and create much uncertainty in the field of liquidations.To some extent, business rescue must surely override liquidation proceedings to give effect to the accepted idea that it is preferable to save a viable enterprise rather than to liquidate it.[222]

When coming to interpretation, some courts argue that the Act must be interpreted in line

[216] s 131(6) of the Act.
[217] Elliott & Weyers "The abuse of business rescue: beware the serial debtor" 2014 December *Lexology* http://www.lexology.com/library/detail.aspx?g=a9068cb0-1b6f-4554-9bf8-89ff409392f3 (Accessed: Date 30 October 2015).
[218] *Richter* case n 9 above.
[219] *Richter* case (n 53 (2014)) above 18.
[220] *Richter* case n 9 above 18.
[221] *Richter* case n 9 above.
[222] Cassim n 102 above 790.

with the promotion of economic development in its entirety, while simultaneously encouraging entrepreneurship and flexibility in the maintenance of companies.[223] On the other hand some caution against the abuse of the process. According to Patel,[224] the only available remedy against abuse of this nature is an interpretation by the courts that the winding-up process must continue despite the pending adjudication of the business rescue application, alternatively a legislative amendment to that effect. However, this suggestion goes against the purpose of the provisions of section 131(6).

The issue as to what liquidation proceedings in the context of section 131(6) is in need of judicial interpretation. The uncertainty created by the confusing use of terminology is highly undesirable and should be clarified by amending the provision. Based on the concrete analysis above, this mini dissertation proposes and recommends that the legislature ought to amend the Act and include a definition of liquidation proceedings, or alternatively introduce an explanatory note to that effect. The introduction of the definition of liquidation proceedings will help give insight as to the intention of the legislature in introducing the relief granted in section 131(6) of the Act. The issue is arguably in most critical need of an explanatory note or a legislative amendment as recommended.

[223] *Nedbank Ltd v Bestvest 153 (Pty) Ltd* [2012] 4 All SA 103 (WCC) at 18.

[224] Patel "Abuse of business rescue proceedings"2014 March *Lexology*.http://www.lexology.com/library/detail.aspx?g=6201fd9c-a6ee-47ed-806a-6e7b00e19262 (Accessed: Date 03 July 2015).

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