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A critical analysis of the business rescue requirements according to *Newcity Group v Allan David Pellow* and section 131(4) of the Companies Act of 2008

by

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DECLARATION

I confirm that this is the final corrected version of my minor dissertation. I declare that no unethical research practices were used or material gained through dishonesty. I herewith declare that my academic work is in line with the Plagiarism Policy of the University of Johannesburg which I am familiar with.

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30 October 2016
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1. Introduction

The concept of “business rescue” was introduced into our law for the first time in Chapter 6 of the Companies Act 71 of 2008 which came into operation on 1 May 2011. Among the recent spate of case law on the business rescue provisions is the decision of Newcity Group (Pty) Limited v Allan David Pellow N.O. and Others. This is probably one of the most important cases where the Supreme Court of Appeal (SCA) had the opportunity to interpret the controversial recovery requirement under business rescue proceedings. The court had to critically analyse the meaning of the word “prospect” and determine whether the future prospects of rescuing the business appeared to be reasonable. In this case, it was pointed out that conflicting viewpoints exist as to exactly how a court should determine whether the recovery requirement has been proved. Maya JA referred to some of the cases that also dealt with the phrase “reasonable prospect” and the way the concept was interpreted and applied. He acknowledged that every case should be judged on its own merits and facts and that less is required in some instances.

In considering the same question which he was faced to address, Van Eeden JA summarised the recovery requirement as follows:

If objectively there is a possibility or likelihood of those uncertain future events occurring, the jurisdictional requirements have been satisfied, and the court can exercise its discretion.

This judgment is of particular interest because it appreciates the various unclear, perhaps misunderstood meanings of the concept as set out in precedents, as well as the pragmatic approach used to determine a reasonable prospect of rescue, and to what extent business rescue may be used to benefit parties other than the business being rescued.

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1 Anderson “Viewing the proposed South African business rescue provisions from an Australian perspective” 2008 PER 1 7.
2 Newcity Group v Allan David Pellow NO (577/2013) [2014] ZASCA 162 (1 October 2014).
3 Newcity case (n 2)
4 Newcity case (n 2) par 16.
5 Joubert “‘Reasonable possibility’ versus ‘reasonable prospect’: Did business rescue succeed in creating a better test than judicial management?” 2013 THRHR 550 561.
6 The unclear meaning given to the phrase “reasonable prospects” and the way it was interpreted and applied in various other cases. It was then concluded that when applying this phrase, the bar must not be set too high and that a reasonable prospect must be present without speculation. There is need to judge each case by its own merits and facts.
Maya JA agreed with the guidelines laid down by Brand JA in *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd*,\(^7\) that a “reasonable prospect” can be described as a yardstick higher than “a mere *prima facie* case or an arguable possibility” but less than a “reasonable probability”.\(^8\) He also agreed with Van der Merwe J that the bar must not be placed too high.\(^9\) However, Maya JA disagreed with Van der Merwe’s view in *Propspec Investments (Pty) Ltd v Pacific Coast Investments*,\(^10\) that “in order to succeed in an application for business rescue, the applicant must place before the court a factual foundation for the existence of a reasonable prospect that the desired object can be achieved” though it will not be necessary to “attempt to set out the minimum particulars of what constitute a reasonable prospect”.\(^11\) Maya JA concluded that there is no need for a detailed plan but only for establishment of grounds for the reasonable prospect of achieving one or two goals set out in section 128(1) (b) of the Companies Act.\(^12\)

2. Problem statement

The Companies Act 71 of 2008 provides for a corporate rescue regime that is in line with the modern South African economy. It provides for one of the crucial components of a successful business rescue application, which is to prove that prospects exist for the company’s recovery based on reasonable grounds. This means that in any business rescue application, the courts should be satisfied that there is a reasonable prospect of rescuing the company. Without this, the court cannot grant such an application. This issue is of paramount importance since many are of the view that liquidation should not be the only possibility that a financially distressed company should be facing, and that business rescue proves to show better results than shutting down a company.

The interpretation and meaning of “reasonable prospect of rescue” has been dealt with in several judgments. The question now is thus whether the courts have succeeded in setting clear guidelines which can be followed in order to successfully apply for business rescue. In discussing this determination, this dissertation will examine certain provisions of the Act as well as certain judgments which dealt with the concept of proving a reasonable prospect of

\(^{7}\) *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others* 2013 4 SA 539 (SCA).

\(^{8}\) *Newcity* case (n 2) par 16.

\(^{9}\) *Newcity* case (n 2) par 16.

\(^{10}\) *Propspec Investments (Pty) Ltd v Pacific Coast Investments* 97 Ltd and another 2013 1 SA 542 (FB).

\(^{11}\) *Propspec Investments* case (n 10) par 11 and 15. See also *Newcity* case (n 2) par 16.

\(^{12}\) *Newcity* case (n 2) par 16.
rescuing a company. Furthermore the dissertation will focus on the relevant views of legal scholars as discussed in various journal articles and critically analyse these contributions in relation to the choice between business rescue and liquidation. A considerable part of this thesis will also deal with the requirement of a secondary goal being present, which is a better return for creditors. Section 131(4)(a) of the 2008 Companies Act states that if it seems unlikely that a company will be returned to its previous state of solvency, the secondary goal, which is to provide a better return to creditors, can be used for a successful application. The dissertation will be concluded with a critical analysis of the final judgment passed by the court in the Newcity case. This is to determine if the court in this case gave a just and equitable judgment of granting a liquidation order. Business rescue provisions as set out in the Act need to be proved before granting the application for business rescue. However, due to the vague and undefined nature of the term “reasonable prospect of rescue”, there is a need for greater clarity in interpreting the term.

3. The facts of the case

This appeal case was lodged against the judgment of the South Gauteng High Court, Johannesburg, where the court dismissed the appellant’s application to place Crystal Lagoon Investments (Pty) Limited under supervision and business rescue in terms of section 131 of the Companies Act 71 of 2008, instead granting an order placing it under final liquidation.

The appellant Newcity (Newcity Group) was the sole shareholder of Crystal Lagoon. It brought an application to have Crystal Lagoon placed under supervision and business rescue. The basis of the application was that

(a) Crystal Lagoon was financially distressed;

(b) it was just and equitable for financial reasons; and

(c) there was a reasonable prospect of rescue

It was argued that business rescue would provide a better ground to operate on. With business rescue comes temporary supervision and management of the company’s affairs, business and property, a temporary moratorium on the rights of claims against it or in respect of property in

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13 Section 131(4) (a) of the Companies Act of 2008.
14 Newcity case (n 2).
15 Newcity case (n 2) par 1.
its possession, and the development and implementation of a plan to rescue it from liquidation. This would result in a better return for its creditors and shareholders than would result from liquidation as envisaged in section 128(1) (b) of the Companies Act.\textsuperscript{16} Newcity Group’s application was based on the provisions of section 131 of the Act. In terms thereof, an affected person, including a shareholder, may apply to a court for an order placing the company under supervision and commencing business rescue proceedings.\textsuperscript{17} It therefore remained to be determined by the court whether there was a reasonable prospect of rescuing the company and, if so, whether the court should exercise its discretion to grant the relief sought.

4. The court’s decision

The Supreme Court accepted that Crystal Lagoon was financially distressed since it was unable to pay its debts as they became due and payable within the immediately ensuing six months.\textsuperscript{18} It held that a business rescue plan was not needed in order to determine whether a reasonable prospect for its rescue existed, but that the company only had to advance facts that can be developed into a plan that, if approved, will maximise the likelihood of the company continuing in existence on a solvent basis or results in a better return for the company’s creditors or shareholders than would result from the immediate liquidation of the company.

A reasonable possibility of either of these two events occurring would enable the court to grant the relief sought, but the proposed plans and/or facts brought forward by Newcity Group did not create a reasonable prospect that the company could be rescued. The court concluded that the company could be sold as a going concern, taking into consideration the interest and rights of the parties who favoured finality, and a final winding-up order was granted.\textsuperscript{19} Section 131(4) of the Act gives the court the power to order business rescue proceedings or to dismiss such an application, taking into consideration the various provisions of the Act together with any further necessary and appropriate order, including an order placing the company under liquidation.\textsuperscript{20}

To determine the meaning of a “reasonable prospect”, the court took the view of Brand JA in \textit{Oakdene Square Properties (Pty) Ltd},\textsuperscript{21} that it was a yardstick higher than “a mere \textit{prima facie}
case or an arguable possibility” but lesser than a “reasonable probability”. Based on all the facts before the court, it was concluded that Newcity Group had failed to establish that there was a reasonable prospect that business rescue would return the company to solvency or provide a better return for its creditors; as a result the appeal was dismissed.

5. Analysis of the judgment

5.1 The choice between business rescue and liquidation

Section 7(k) of the Act gives guidance when a choice between business rescue proceedings and liquidation should be made. The section encourages “efficient rescue and recovery of financially distressed companies in a manner that balances the rights and interests of all relevant shareholders.” The court found the choice of liquidation to be a more appropriate remedy that would balance the interests of all stakeholders under the given circumstances. Maya JA argued that considering that the company had already been in business rescue at an earlier stage, and which proceedings were halted giving room for provisional liquidation orders, it would appear that the parties in favour of the liquidation wanted finality. The court acknowledged that it had been established with certainty that there was preference of one creditor above the other. It was established that firstly, with reference to their powers, a liquidator is vested with the authority to sell real estate such as the hotel property, which would enable China Construction Bank Corporation (CCBC), as a secured creditor, to receive the debt due to it and also have a concurrent claim for undisputed interest.

Secondly, a liquidator would have the power to impeach certain dispositions made during a property development loan facility agreement. This would be in the best interest of CCBC which had various securities, including deeds of suretyship and a first mortgage bond, registered over the hotel property. These powers were both essential in the present case.

On the other side of a coin, arguments in favour of business rescue were twofold. Newcity Group relied on a measure of changing the management of the company as well as securing a third-party investment for financial relief. For doing so they relied on the business rescue practitioner’s powers as set out in section 136(2) in which he or she may entirely, partially or

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22 Newcity case (n 2) par 16.
23 Newcity case (n 2) par 16 and 23.
25 Newcity case (n 2) par 22.
26 Newcity case (n 2) par 3.
conditionally suspend any obligation of the company that arises as well as any unjust and unreasonable terms thereof. The court was convinced that replacing the current hotel management by the Rezidor Hotel Group with that of the Extrabold Hotel Group would not achieve the standard of reasonableness since there would be a large expense incurred and no evidence was provided in terms of financial assistance upon commencing the changeover programme. Moreover, no evidence was presented that the company had any grievance with the management of the Rezidor Hotel Group, and thus this management company might oppose such a move in a court of law. As a result, the court was not satisfied that this averment addressed the cause of the demise of the company nor did it provide any objective grounds for success but would rather add more gravity to the shaken Newcity Group and its down-trodden company Crystal Lagoon. The finality which liquidation stands to offer was the only thing needed in this kind of crisis.

Apart from these external challenges, there were also some internal factors which helped drag Crystal Lagoon and its sole shareholder down the long route to liquidation. It was alleged that the business rescue practitioner himself lacked competence and for that reason the creditors rejected his appointment. To start with, he was expected to deliver a business rescue plan for which he twice sought an extension to file. He had failed, in the entire period of two years, to provide a feasible business rescue plan as expected. In terms of section 139, business rescue practitioners must be held to high professional and ethical standards, and if they fail in establishing such a standard, they would be subject to removal by a court order. As Bradstreet states, the effectiveness of the new business rescue procedure will depend to a large extent on the way in which the rescue practitioner implements the business rescue plan, and therefore also on the practitioner’s ability to manage the process. CCBC objected to the application for business rescue because it was the majority creditor, and alleged that the practitioner was incompetent. CCBC stood to lose the most and the court was not going to accept anything which did not either support a better deal for creditors or return the company to solvency.

27 Newcity case (n 2) par 8 and s 136(2) of the Companies Act 71 of 2008.
28 Newcity case (n 2) par 8.
29 Newcity case (n 2) par 19.
30 Newcity case (n 2) par 9.
31 Newcity case (n 2) par 6.
32 Newcity case (n 2) par 9.
33 Section 139 of the Companies Act.
35 Newcity case (n 2) par 9 and 23.
36 Newcity case (n 2) par 12, 20 and 21.
Bradstreet states that the practitioner is in a sense, the “weakest link” for creditors, since creditors who were unhappy were most likely to engage him or her in litigation.\(^{37}\) He further contends that the Act and regulations should seek to avoid any potential problems that may give rise to litigation, lest the result of the process be effectively disadvantageous to creditors.\(^{38}\) In this specific case, the practitioner relied on so-called “expressions of interest”\(^{39}\) from unspecified entities which they expected “in the near future”.\(^{40}\) Bradstreet blames the broad powers granted and lack of extrajudicial accountability in the rescue procedure itself, which serves to reinforce the need for a sufficiently high degree of competence required of the person holding the office of practitioner. He is of the opinion that the appointment of any “loose-cannon” practitioners, particularly in the initial stage of business rescue, would create the risk of fostering an impression of volatility in the Chapter 6 procedure and lead to creditors being unwilling to grant financial assistance.\(^{41}\) This loophole would mean that liquidation would be the most likely and least painful solution worth grabbing.

Although the Companies Act encourages the implementation of business rescue proceedings in preference to liquidation, it remains important to weigh these two options carefully. Business rescue proceedings have their own inherent disadvantages. For instance, considering section 128 to section 154 of the Act, it seems business rescue proceedings are “open-ended” and in particular could extend over a significant period of time. Thus the general moratorium to suspend any contractual obligation of the company for the duration of the proceedings in section 136 could cause serious disadvantage to creditors.\(^{42}\) For instance, it might imply that Crystal Lagoon, as a company under business rescue, could continue to occupy rented premises without paying rent, at the expense of the owner. The practitioner may also decide to suspend payment for services such as those received from Rezidor as the hotel managing company, as indeed the company had failed to pay for these services for more than three years already.\(^{43}\) The creditors would also be prevented from instituting legal action for any reason at all.\(^{44}\) The moratorium could last as long as the company’s so-called “ramp-up phase” of four years.\(^{45}\) Small companies would face serious financial difficulties if they were not paid amounts due and payable to

\(^{37}\) Bradstreet (n 34) 212.
\(^{38}\) Bradstreet “The leak in the Chapter 6 lifeboat: inadequate regulation of business rescue practitioners may adversely affect lenders’ willingness and the growth of the economy” 2010 SA Merc LJ 195 212.
\(^{39}\) Newcity case (n 2) par 6.
\(^{40}\) Newcity case (n 2) par 8 and 6.
\(^{41}\) Bradstreet (n 34) 212.
\(^{42}\) Section 128 to 154 of the Companies Act of 2008.
\(^{43}\) Newcity case (n 2) par 20.
\(^{44}\) Newcity case (n 2) par 9.
\(^{45}\) Newcity case (n 2) par 12.
them. Furthermore, if a company is subject to business rescue proceedings, a guarantee or a surety in respect of its liabilities in favour of any other person may not be enforced against the company that granted it, unless the court grants leave to do so on terms it considers just and equitable in the circumstances, in this case resulting in the security for the loan which CCBC took, including a deed of suretyship from Cohen, and a mortgage bond registered over the hotel not being enforceable against Newcity Group.

It is submitted that nothing that could be forthcoming from the business rescue proceedings would thus have been of any interest to these creditors, who would not have been satisfied with anything less than a final liquidation order. The court concluded that Newcity Group had failed to establish any one of the two objectives of business rescue. Even if one had been established, the court deemed rescue not possible given the remote possibility of success of the rescue plan. Suffice it to say, however, that our courts have firmly stipulated that there is no reason to assume that a liquidator would not be able to sell assets at their market value or would get a lower price than a business rescue practitioner would be able to attain.

5.2 Costs, delays and litigation

It was correctly contended on behalf of CCBC that Newcity Group’s calculations overlooked the litigation costs that would be incurred in relation to the termination of the management agreement with Rezidor. Another entity, Extrabold, was going to replace Rezidor as hotel management group, while Rezidor claimed it would resist such a change. Even Judge Eloff criticised this proposed change by saying the following:

A business plan which is unlikely to achieve anything more than to prolong the agony ... by substituting one debtor for another without there being light at the end of a not too lengthy tunnel, is unlikely to suffice.

47 Rushworth “A critical analysis of the business rescue regime in the Companies Act 71 of 2008” 2010 Acta Juridica 375 384. See also Newcity case (n 2) par 3.
48 Newcity case (n 2) par 23.
49 Loubser (n 46) 449.
50 Newcity case (n 2) par 21.
51 Newcity case (n 2) par 19.
52 Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd 2012 (2) SA423 (WCC) par 24.
Newcity Group also challenged Crystal Lagoon’s indebtedness to Absa but nothing fruitful was achieved.\(^{53}\) The number of disputes that would have to be mediated by the business rescue practitioner militated against the possibility of him being able to do so.

A final blow that Crystal Lagoon and its sole shareholder could not survive was the uncertainty regarding the costs of commencing a business rescue. There were the costs of paying the business rescue practitioner as well as some interest on credits that had already accrued and which was already due and payable. Further, there were also costs to be paid in terms of the Extrabold lease agreement, attorneys’ and directors’ fees in addition to the business practitioner’s costs, and transactional fees.\(^ {54}\) In contrast to this, a liquidator would only need to gather the company’s property and liquidate the same, at a far lower cost.\(^ {55}\)

It is alleged in Newcity Group’s affidavits that the costs of liquidation would exceed those incurred in business rescue. But, as was pointed out in the *Oakdene Square Properties* case,\(^ {56}\) the “mere savings on the costs of the winding-up process in accordance with the existing liquidation provisions can hardly justify the separate institution of business rescue”. But even though this was alleged, Newcity Group’s business rescue plan did not even show that such a saving was possible.\(^ {57}\) Pretorius and Rosslyn-Smith agree that a rescue plan that is communicated properly will help clarify and safeguard critical resources. It can also be used for legal action against anyone involved.\(^ {58}\) But Newcity Group’s business rescue plan was unlikely to achieve anything at all.

The court below thus calculated the costs, delays and litigation that would follow business rescue and concluded that there was nothing which created a reasonable justification of granting the order. The court concluded that as things stood, the company could be sold as a going concern, and a balancing of the parties’ rights and interests’ favoured finality and the granting of a final winding-up order.\(^ {59}\)

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53 *Newcity* case (n 2) par 12.
54 *Newcity* case (n 2) par 21.
55 *Newcity* case (n 2) par 23.
56 *Oakdene Square Properties* case (n 7).
57 *Newcity* case (n 2) par 21.
59 *Newcity* case (n 2) par 10.
5.3 A better return for creditors than in immediate liquidation

The central debate underlying the case of *Oakdene Square Properties* was what constituted rescuing the company within the meaning of section 131(4) (a).\(^{60}\) One of the debates was whether it is enough for a plan to provide for the possibility of a secondary goal only, where it is clear from the onset that the company will never return to its solvent position.\(^{61}\) In the case of *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd and Others*,\(^{62}\) the court held that the status of the alternative objective depends primarily on the interpretation of the Act but the creation of the alternative objective will give rise to more litigation.\(^{63}\) It held that section 131(4) does not incorporate the alternative objective of granting a better return for creditors or shareholders than would result upon liquidation. The court, it seems, favoured the secondary effect of a better return to creditors rather than the primary aim.\(^{64}\)

In light of the circumstances of the *Newcity* case,\(^{65}\) 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 liquidation would achieve better results than business rescue.\(^{66}\) The *Newcity* case followed the judgment in the case of *Oakdene* in which the court concluded that both goals have to be achieved,\(^{67}\) therefore the company should be returned to solvency, or provide a better deal for creditors and shareholders than what they would receive through liquidation.\(^{68}\) In the *Newcity* case, however, providing a better return for CCBC as a creditor proved to be impossible. This clearly shows that business rescue on the proposed offers would not result in a better return for CCBC than what it would otherwise receive in liquidation proceedings.\(^{69}\) The court accordingly concluded that the achievement of any of the two goals referred to in section 128(1) (b) would qualify the applicant for business rescue in terms of section 131(4) of the Companies Act.\(^{70}\)

In the case of *Swart v Beagles Run Investments*,\(^{71}\) the court regarded the goal of ensuring a better return for creditors as an independent goal that should be protected in terms of the plan

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\(^{60}\) *Oakdene Square Properties* case (n 7).

\(^{61}\) *Oakdene Square Properties* case (n 7) par 23.

\(^{62}\) 2012 5 SA 515 (GSJ).

\(^{63}\) *AG Petzetakis* case (n 62) par 12.

\(^{64}\) *AG Petzetakis* case (n 62) par 17.

\(^{65}\) *Newcity* case (n 2).

\(^{66}\) *Newcity* case (n 2) par 23.

\(^{67}\) *Oakdene Square Properties* case (n 7).

\(^{68}\) *Oakdene Square Properties* case (n 7) par 26.

\(^{69}\) *Newcity* case (n 2) par 22.

\(^{70}\) *Oakdene Square Properties* case (n 7) par 26. See also s 128 and 131 of the 2008 Companies Act.

\(^{71}\) *Swart v Beagles Run Investments* 2011 5 SA 422 (GNP).
so that the creditors would not be worse off in the event that rescue fails. The same view was echoed in *Southern Palace Investment v Midnight Storm Investments*, where the court went further to hold that the plan should include the resources which will be available to the company together with the terms thereof, otherwise it would be “mere speculation” to say that creditors would be better off under business rescue supervision than they would with liquidation of the company. With regard to the secondary goal, Bradstreet explains that its usefulness depends on the policy considerations on a case-by-case basis. Where there is a reasonable prospect of rescue, creditors’ interests are considered as “secondary” though protection of their interests is an alternative goal, but what should prevail is the ruling in *Oakdene Square Properties*. The term “business rescue”, as its name suggests, does not necessarily guarantee that a company will not ultimately be liquidated, but if it happens it still has to result in a better return for creditors than immediate liquidation would have provided. This therefore means that “rescuing” the company does not mean salvaging the wreck at all costs, but rather making an appropriate use of the procedure in a manner which is in the best interest of all stakeholders and shareholders. Section 128 (1) (b) thus seems to protect the interests of creditors by providing for the secondary goal. The secondary goal did not seem to be a realistic possibility in this case and thus the court concluded that immediate liquidation was a better choice.

### 5.4 Debt and lack of funding

Crystal Lagoon was hugely indebted and had not made a single payment either towards the interest or capital on their loan with CCBC. CCBC withdrew the loan facility on the basis of non-payment and as a result of the company having exceeded the facility agreement. Moreover, a close look at each of the “third party offers” mentioned indicated they were not commercially viable. They would not have resulted in temporary supervision and were, in any event, probably no longer available. Newcity Group required CCBC to write off substantial portions of the loan facility, to provide new funding and forfeit the securities put up by Crystal Lagoon.

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72 Sharrock et al *Hockley’s Insolvency Law* 276; s 136(1) (a) of the Companies Act 71 of 2008.
73 *Southern Palace* case (n 52).
74 Sharrock et al (n 72) 276; s 136(1) (a) of the Companies Act 71 of 2008.
76 Burdette “Some initial thought on the development of a modern and effective business rescue model for South Africa (Part 1)” 2004 *SA Merc LJ* 241 244. See definition of “business rescue” in section 128(1)(b).
77 Bradstreet (n 75) 51.
78 Bradstreet (n 75) 51. See also *Swart v Beagles Run Investments (Pty) Ltd*.
79 *Newcity* case (n 2) par 9.
80 *Newcity* case (n 2) par 18.
This thus came down to a mere substitution of Crystal Lagoon with another debtor. The projected fixed rental which would have been received from the lease agreement which Extrabold proposed with Crystal Lagoon would not even have covered the monthly interest payment that was required. Rezidor agreement was merely a “statement of the parties’ intentions and subject to the conclusion of ‘Formal Agreements’. None of the conditions came to fruition and the agreement failed because Rezidor itself had neither approved the proposed transaction nor was willing to confirm that it had raised the necessary funding.81

This was also one of the central debates found in DH Brothers Industries (Pty) Ltd v Gribnitz,82 where the court concluded that Dowmont was hopelessly insolvent and unable to pay its debt since it kept on accumulating further debt. There was no conceivable reason not to grant a provisional liquidation order following the circumstances under which the company was operating its business.83 The simple fact is that Crystal Lagoon remained unable to service existing debt, was likely to accumulate further debt and even failed to pay its managing company, Rezidor. Neither the proposed replacement of Rezidor with a different managing group, nor the touted third-party funding offers, created a reasonable prospect of rescue.84

6. Business rescue under section 131(4) (a) of the 2008 Companies Act

6.1 The meaning of “rescuing the company”

The court in the Newcity case acknowledged that rescuing of a company meant achieving the goals of “business rescue” set out in section 128(1) of the Act, considering most importantly that this goal is primarily directed at the prevention of unnecessary liquidations of companies and the consequent loss of employment. It also stated that if only one of the goals is fulfilled, then this would have satisfied the requirements of the Act, and in this case, liquidating Crystal Lagoon would destroy the business and lead to the loss of employment, which is against the goals of rescue.85 Anderson correctly stated that the primary goal reflects the wide acceptance that reviving the business or at least a significant portion of it, even though it may be technically insolvent, adds value to society and is favoured above straight liquidation.86

81 Newcity case (n 2) par 19.
82 DH Brothers Industries (Pty) Ltd v Gribnitz NO & Others 2014 1 SA 103 (KZP).
83 DH Brothers case (n 82) par 12.
84 Newcity case (n 2) par 20.
85 Newcity case (n 2) par 10 and 12.
86 Anderson (n 1) 7.
According to section 131(4) (a) a court may make an order placing a company in business rescue provided that the court is satisfied that

(i) the company is financially distressed; (ii) the company has failed to pay over any amount in terms of an obligation under or in terms of a public regulation, or contract, with respect to employment-related matters; or (iii) it is otherwise just and equitable to do so for financial reasons, and there is a reasonable prospect for rescuing the company.87

It is plain from the wording of these provisions that a court may not grant an application for business rescue unless there is a reasonable prospect of “rescuing the company”.88 This implies to facilitate its rehabilitation so that it continues on a solvent basis or, if that is not possible, yields a better return for its creditors and shareholders than what they would receive through liquidation.89 In deciding that question, the court has to exercise its discretion and in this case it dismissed the appeal simply by reason of Newcity Group’s failure to establish that there was a reasonable prospect to rescue Crystal Lagoon considering the interests of the creditors, shareholders, employees and the public at large.90

Crystal Lagoon was in debt arrears.91 It had also failed to pay its managing company for more than three years.92 CCBC had already taken various securities, including a deed of suretyship and a mortgage bond registered over the hotel.93 The granting of the order therefore turned on the issue of whether a business rescue practitioner would do better than a liquidator in salvaging as much as possible from the wrecked company.94 Looking at the circumstances in which the applicant was operating, one cannot be in doubt that the primary goal of achieving “business rescue” as set out in section 128(1) of the Act was deemed to be unattainable.95

6.2 “Just and equitable … for financial reasons” to grant order

When there is an application in terms of section 130(1), the court may set aside the company’s resolution if it considers such an order not to be just and equitable.96 Conversely, in applications
in terms of section 131(1)\textsuperscript{97} and section 427(1), an order may be granted by a court that considers the commencement of a business rescue to be just and equitable.\textsuperscript{98} This catch-all phrase enables the court to prevent abuse of process by the debtor, just for the sake of trying to avoid the unwanted liquidation.\textsuperscript{99} A court may grant a business rescue order if it is satisfied that “it is otherwise just and equitable to do so for financial reasons”.\textsuperscript{100} The court noted that Newcity Group and CCBC were both affected persons as envisaged in section 128(a) (i) of the Act. It was undisputed that Crystal Lagoon was financially distressed within the contemplation of section 131(4) (a) (i) as it was both commercially and factually insolvent. It was unable to pay CCBC’s debt, which was already due and payable. It is worth mentioning that the court recognised the importance of considering the interests of both affected parties and found that the “financial reasons” referred to all creditors, particularly to CCBC and Newcity Group as the sole shareholder. The court reasoned that it would naturally apply to affected persons, but most importantly, to the company because it is the financial health of the company that is financially distressed which is primarily at stake in an application for business rescue.\textsuperscript{101}

The entry route to a successful business rescue application, as the court suggested, is that there should be a reasonable prospect of rescue and it should be just and equitable to grant the application.\textsuperscript{102} Bradstreet is of the view that the punctuation used in the Act seems to suggest that this requirement is only applicable when commencement is by board resolution, or an application is granted specifically on the basis of section 131(4)(a)(iii), where granting an order would be otherwise just and equitable for financial reasons. He suggests that an affected person applying for a business rescue order in terms of section 131(4) (a) (i) would only need to show that the company is financially distressed but, given time, would get back to a solvent state.\textsuperscript{103}

6.3 The meaning of the notion “financially distressed”

The first specific requirement for a company to be defined as “financially distressed” is set by section 427(1) of the Companies Act of 1973, stating that the company must be unable to pay its debts or is probably unable to meet its obligations.\textsuperscript{104} The court did not dispute that Crystal Lagoon was financially distressed within the contemplation of section 131(4)(a)(i) as it was

\textsuperscript{97} Section 131 (1) of the Companies Act 71 of 2008.
\textsuperscript{98} Section 427 (1) of the Companies Act 61 of 1973.
\textsuperscript{99} Bradstreet (n 34) 369.
\textsuperscript{100} Section 131(4) of the Companies Act 71 of 2008.
\textsuperscript{101} Newcity case (n 2) par 11.
\textsuperscript{102} Section 131(4) of the Companies Act 71 of 2008.
\textsuperscript{103} Bradstreet (n 75) 48.
\textsuperscript{104} Section 427(1) of the Companies Act 61 of 1973.
both commercially and factually insolvent. It was unable to pay its debt to CCBC, which was
due.\textsuperscript{105} Section 128(1)(f) defines “financially distressed” to mean that it appears to be
reasonably unlikely that the company will be able to pay all of its debts as they become due and
payable within the immediately ensuing six months, or it appears to be reasonably likely that
the company will become insolvent within the immediately ensuing six months.\textsuperscript{106}

CCBC withdrew the loan facility on the basis of non-payment and the fact that the company
had exceeded the facility agreement amount as agreed. It was argued on behalf of Newcity
Group that the company was in the challenging start-up phase, the so-called “ramp-up phase”
during which a newly opened hotel attempts to penetrate the market and get established.\textsuperscript{107}
Even the “third-party offers” mentioned proved to be merely “expressions of interest” and were
not commercially viable. In any event these would not have resulted in temporary supervision.
On top of being provided with new funding, Newcity Group required CCBC to write off
substantial portions of the loan facility and forfeit the securities put up by Crystal Lagoon, to
which CCBC was not prepared to accede.\textsuperscript{108}

In this regard, Traverso DJP in \textit{Gormley v West City Precinct Properties}\textsuperscript{109} held that business
rescue should apply only to companies that are financially distressed as defined in section
128(1)(f). In this case, the court held that the company was presently insolvent and would not
be able to pay its debts unless a moratorium of three to five years were granted. It was contended
that the facts of the matter were not sufficient to bring West City’s financial situation within
the definition of being “financially distressed”. The judge stated that business rescue was meant
to be a short-term approach and “a viable rescue plan must contain facts to show that if the
intended resuscitation of the company should fail, the creditors will not be worse off”. On the
facts, the court found the company in question to be insolvent in such a degree that it did no
longer fall within the definition of “financially distressed”. The business rescue application was
therefore dismissed and the company was placed in provisional liquidation. This judgment
highlights the fact that a company can indeed be insolvent to such a degree that it do not qualify
for business rescue.\textsuperscript{110}

\begin{itemize}
\item \textsuperscript{105} \textit{Newcity} case (n 2) par 11.
\item \textsuperscript{106} Section 128(1)(f) of the Companies Act 71 of 2008
\item \textsuperscript{107} \textit{Newcity} case (n 2) par 12.
\item \textsuperscript{108} \textit{Newcity} case (n 2) par 18.
\item \textsuperscript{109} \textit{Gormley v West City Precinct Properties} 19075/11 (WCC) (18 April 2012).
\item \textsuperscript{110} \textit{Gormley} case (n 109) par 13.
\end{itemize}
The simple fact is that Crystal Lagoon remained unable to service its debt due to CCBC and even yielding any concrete funding. But there was a more challenging position for Newcity Group to overcome. On its version of its financial affairs, the value of its assets exceeded its debts. The court in the Oakdene Square Properties case acknowledged that it is common cause that, although the company appears to be factually solvent in that the value of its assets exceeds its debts, it is unable to satisfy the judgment debt, in this case in favour of Nedbank. This means that the company in this case was both commercially insolvent for liquidation purposes and financially distressed within the contemplation of section 131(4) (a) (i). Thus in the Newcity case, only liquidation would have provided a payment to CCBC which would be over and above of what it would expect if the company were put under business rescue. However, none of the proposed offers which favoured business rescue came anywhere close to promise a better return to the main creditor.

Financial distress of a company may also be proved by the non-payment of amounts due in respect of contractual or statutory obligations in employment matters. This provision can already be applied even if only one payment is missed, for any reason. Crystal Lagoon failed to pay its management firm, Rezidor, in over three years. Loubser explains that there should be a minimum period or frequency before such obligations in employment matters constitute a ground for rescue proceedings and can be applied where at least two consecutive payments are missed. This shows the broadening of the definition of financial distress of a company which is more advantageous to applicants who do not have easy access to the financial information required to satisfy the court when applying for an order to commence the procedure. Crystal Lagoon even failed to pay the monthly interest for several months, despite CCBC’s repeated demands, thereby breaching the facility agreement concluded.

In the case of African Banking Corporation of Botswana v Kariba Furniture Manufacturers it was stated that business rescue proceedings were a sham and were instituted for an ulterior

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111 Newcity case (n 2) par 20.
112 Newcity case (n 2) par 22.
113 Oakdene Square Properties case (n 7).
114 Oakdene Square Properties case (n 7). See also s 131 of the Companies Act 71 of 2008.
115 Newcity case (n 2) par 22.
117 Newcity case (n 2) par 20.
118 Loubser (n 116) 511.
119 Newcity case (n 2) par 4.
120 (228/2014) [2015] ZASCA 69 (20 May 2015)
and improper purpose since it was clear that the company would never return to a solvent position.\textsuperscript{121} In \textit{Gormley v West City Precinct Properties}\textsuperscript{122} it was also highlighted that business rescue should apply only to companies that are financially distressed as defined in section 128(1)(f). The judge stated the following:

\begin{quote}
It must either be unlikely that the debts can be repaid within six months or that there is the likelihood that the company will go insolvent within the ensuing six months. In this case the company is presently insolvent and cannot pay its debts unless a moratorium of three to five years is granted. The facts of this matter do not bring West City’s financial situation within the definition of “financially distressed”. That should, in my view, be the end of the matter.\textsuperscript{123}
\end{quote}

In this case, it was held that business rescue is meant to be a “short-term approach” for self-evident reasons. On the facts, the court found the company in question to be insolvent to such a degree that it did not fall within the definition of “financially distressed”. The court thus dismissed the business rescue application and placed the company under provisional liquidation.\textsuperscript{124}

In conclusion, as Loubser states as well, the majority of companies should not try to avoid “the prying eyes of a liquidator” which, if used correctly and wisely, can sometimes achieve the same or maybe even better results, than a formal business rescue procedure.\textsuperscript{125}

6.4 Prospect based on “reasonable grounds”

There is a dual gateway to commence business rescue proceedings either voluntarily or through a court order;\textsuperscript{126} both require that reasonable prospects exist that the struggling company can be rescued. It is quite a drawback for interpretation that the Act fails to provide a definition of the phrase “reasonable prospect of rescue”\textsuperscript{127} and yet considers it a fundamental element in the granting of a business rescue application. If there is no reasonable prospect for success, then the court may set the application aside and make an order placing the company under liquidation.\textsuperscript{128}

\textsuperscript{121} \textit{African Banking} case (n 120) par 26-33.
\textsuperscript{122} \textit{Gormley} case (n 109).
\textsuperscript{123} \textit{Van Der Merwe and Others v Zonnekus Mansion (Pty) Ltd and Others} (4653/2015) [2015] ZAWCHC 90 par 14.
\textsuperscript{124} \textit{Van Der Merwe} case (n 123) par 16.
\textsuperscript{125} Loubser (n 46) 457.
\textsuperscript{126} Section 128 and 129 of the Companies Act 71 of 2008.
\textsuperscript{127} Meskin et al (n 24) 463.
\textsuperscript{128} Rushworth (n 47) 381.
An attempt to define the term “prospect” was made in the case of *Zoneska Investments(Pty) Ltd t/a Bonatla Properties (Pty) Ltd v Midnight Storm Investments Ltd*.[129] The court stated that the online Oxford English dictionary defines “prospect” as either “the possibility” or “a thing that may happen or be the case”. “Likelihood” is defined as “the state or fact of something being likely probable”.[130] Kollapen J in *Employees of Solar Spectrum Trading v AFGRI Operations Ltd and Solar Spectrum Trading*.[131] added some flesh to the skeleton definition and explained it as follows:

> By its very nature, a prospect is future looking and dependent upon a number of variables and includes a level of risk to the extent that the future is hardly capable of accurate prediction.[132]

The court concluded that what is required is “a determination that the future prospects of rescuing the business” stems from reasonable grounds.[133] The primary objective is that the company will be able to return to trade on a sound financial footing and also offer a better return for the company’s shareholders than what would be available upon liquidation.[134] The court in the *Newcity* case held that if there were a reasonable possibility of the occurrence of either of these two events, the jurisdictional requirements of business rescue would be seen as a successful rescue of an ailing company.[135] Pretorius and Rosslyn-Smith state that a plan should clearly show that the company can recover otherwise the relief sought can be rejected by the courts.[136]

The first reported business rescue judgment was made in 2011, in the same month as the new Act came into effect. Presided over by Judge Makgoba, the judgement in *Swart v Beagles Run Investments*,[137] eagerly awaited as the first test of the new Act, was somewhat of a disappointment. The court ruled that the allegations brought forward were too thin and came nowhere near to convincing the court that there was a reasonable prospect of rescuing the company.[138] In this case, the company was in financial distress and applied for supervision.[139] Creditors argued that business rescue was an abuse of process and an attempt on the part of

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129 2012 4 All SA 590(WCC).
130 *Zoneska* case (n 129) par 39.
132 *Solar Spectrum* case (n 131) par 34.
133 *Solar Spectrum* case (n 131) par 34.
134 Joubert (n 5) 554.
135 *Newcity* case (n 2) par 10.
136 Pretorius and Rosslyn-Smith (n 58) 129.
137 *Swart* case (n 71).
138 *Swart* case (n 71) par 42.
139 *Swart* case (n 71) par 11.
Swart to avoid and/or postpone payment of the debts. The court in arriving at its decision concluded that the respondent was hopelessly insolvent and that the value of the movable and immovable properties were insufficient to ensure payment of its creditors. The applicants placed nothing before the court to indicate that such money could or would ever be repaid. There was complete negation of the rights of creditors. The value of all the assets of the respondent put together were not nearly sufficient to cover its debts or running obligations, thus there was no prospect of recovery based on reasonable grounds. Makgoba J agreed that the notion of a “successful concern” is intended to mean that the concern would be able to carry on its operations effectively in accordance with its main object and yield a return to its shareholders and creditors. The application was said to be inflated and thus rejected. As suggested by Loubser, a company only has to satisfy itself that the company is financially distressed, and that there is a reasonable prospect for rescuing the company.

Rajak and Henning express the same view when they define rescue as including cases where the debtor’s recovery is complete, but indicate that the notion must also be understood to encompass cases where the debtor’s recovery is partial but where the overall result is one of greater benefit to the various interests concerned than would have arisen on liquidation. They suggest that it is reasonable to provide for the rescue of potentially successful debtors as well as for the elimination, commercially speaking, of hopelessly insolvent ones.

Soon after, however, the tables changed in a case that has become the precedent of the judicial interpretation of the requirements for business rescue applications. The judgement in this case did not follow Makgoba J when it was handed down six months after that initial judgment by Eloff AJ in Southern Palace Investments (Pty) Ltd v Midnight Storm Investments. The phrase “a reasonable prospect for recovery” enjoyed special attention. The requirement that a “reasonable prospect” should be indicated by factors that go beyond looking at a mere possibility of success or the providing of information “that goes beyond mere speculation or conjecture”, were criticised in later judgments as putting the “benchmark too high”.

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140 Swart case (n 71) par 12.
141 Swart case (n 71) par 28.
142 Swart case (n 71) par 29.
143 Swart case (n 71) par 12.
144 Swart case (n 71) par 33.
145 Swart case (n 71) par 25.
147 Rajak and Henning “Business rescue for South Africa” 1999 SALJ 262 277.
148 Southern Palace case (n 52).
149 Joubert (n 5) 556.
court held that an applicant seeking relief in the form of the commencement of business rescue proceedings must present to the court enough factual detail to place a court in a position to exercise its discretion judicially in determining whether a business rescue practitioner will probably have a viable basis to rescue the company. Unfortunately, in the case under discussion Eloff JA remarked that there was “no reason to believe that there is any prospect of the respondent being restored to a successful one”.

Delport et al mention that the judgement in *Southern Palace Investments* is far too stringent and may, in future, lead to the ineffectiveness of the business rescue procedure since the evidence and information required will usually not be accessible to an affected person and therefore a business rescue practitioner would be needed to assist in providing such information. But in *Solar Spectrum* the court contended that access to information of the company is a right which should be available especially to affected persons as they deal more closely with the company. The court explained that, generally, a shareholder would have better access to the company in relation to details of the financial position and financial performance of the company than what an employee might have. On the other hand, long-standing employees might have a particular knowledge of the operational performance of the company and might also be in the position to identify solutions and thus could play a vital role in the business-rescue process for an effective outcome.

It appears that the view of Delport et al is shared by Van der Merwe J in *Propspec Investments (Pty) Ltd v Pacific Coast Investments*. But in considering these decisions, Van der Merwe J commented as follows:

> In my judgment it is not appropriate to attempt to set out general minimum particulars of what would constitute a reasonable prospect in this regard. It also seems to me that to require, as a minimum, concrete and objectively ascertainable details of the likely costs of rendering the company able to commence or resume its expenditure, or concrete factual details of the source, nature and extent of the resources that are likely to be available to the company, as well as the basis and terms on which such resources will be available, is tantamount to requiring proof of a probability, and unjustifiably limits the availability of business rescue proceedings.

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150 *Southern Palace* case (n 52) par 23 and 24.
151 Joubert (n 5) 556.
153 *Solar Spectrum* case (n 131) par 17 and 18.
154 *Propspec Investments* case (n 10).
155 *Propspec Investments* case (n 10) par 15.
Van der Merwe J firmly stated that “a factual foundation for the existence of a prospect based on reasonable grounds that the desired object can be achieved” must be evident and, while it is only an “expectation”, it should be one that rests on a ground that is objectively reasonable.\(^\text{156}\) Considering the interpretation of the word “prospect” by the court in the *Propspec Investments* case, to mean an “expectation”, then a reasonable prospect of the recovery of a company will be proved if an applicant can prove such a reasonable possibility resting on objectively reasonable grounds.\(^\text{157}\) Van der Merwe J further stated that “a prospect means an expectation or a possibility, which is proved to be reasonable if it rests on a ground that is objectively reasonable, though a checklist of basic information that would satisfy the recovery is not necessarily required.\(^\text{158}\) Ultimately, the application for business rescue was dismissed. Bradstreet suggests that a legislative reorganisation procedure should be accessible and not erect too high a set of hurdles in the way of companies accessing the procedure. Entry routes should be swift and significantly clear of blockages, for them to be effective and accessible.\(^\text{159}\) This case sets the most realistic requirements to achieve “prospects” based on “reasonable grounds” and is in alignment with the views of most legal writers.

Binns-Ward J in *Koen v Wedgewood Village Golf*\(^\text{160}\) also adopted the requirements laid down by Eloff AJ for successful business rescue applications. He held that what is important is the ability of the applicant to place before the court “a cogent evidential foundation” to support the existence of a prospect based on “reasonable grounds” that the desired object can be achieved.\(^\text{161}\) He added that “vague and speculative averments” would not suffice.\(^\text{162}\) The costs of rendering the business of the company, the availability of cash resources and the reasons for believing that a proposed business plan would have a reasonable prospect of returning the company to a solvent state should be taken into account.\(^\text{163}\) The court accordingly stated the following:

> The applicant has fallen woefully short of furnishing the court with the material required to make the assessment of whether a reasonable prospect of business rescue succeeding exists. Their case is manifestly dependent on the provision by the mystery potential investor of the means to enable a business rescue practitioner to draw up a feasible rescue plan. What those means might be or on

\(^\text{156}\) *Propspec Investments* case (n 10) par 11.
\(^\text{157}\) *Propspec Investments* case (n 10) par 12.
\(^\text{158}\) Joubert (n 5) 560.
\(^\text{159}\) Bradstreet (n 34) 379.
\(^\text{160}\) 2012 SA 378 (WCC).
\(^\text{161}\) *Koen* case (n 160) par 17.
\(^\text{162}\) *Koen* case (n 160) par 18.
\(^\text{163}\) *Koen* case (n 160) par 20.
what terms and conditions they might become available is as much a mystery as the identity of the party which might provide them.\textsuperscript{164}

The court thus concluded that there were no sufficient grounds to find that the company should be put under supervision. The judgement in the \textit{AG Petzetakis case}\textsuperscript{165} suggested the same line of reasoning. The court found that the company was beyond rescue merely because it did not demonstrate up to the required standards that the company can successfully be rescued or achieve the secondary goal as provided by the Act, and therefore business rescue was denied\textsuperscript{166}.

Claassen JA in the \textit{Oakdene Square Properties case}\textsuperscript{167} was in favour of the lower threshold and the court stated that it was generally accepted that a reasonable prospect is a lesser requirement than reasonable probability. But the court pointed out that a reasonable prospect required more than a mere \textit{prima facie} case or arguable possibility for the court to favour a business rescue order\textsuperscript{168}. The court held that a detailed plan upon application is not necessary, as this, according to Eloff J in the \textit{Southern Palace case},\textsuperscript{169} is “to place the cart before the horse”.\textsuperscript{170} However, the court concluded that there was neither business of the company to be rescued, nor any benefit that could be derived from saving the company and thus the secondary goal has not been met for the purposes of section 128(1)(b).\textsuperscript{171} It is submitted that since the decision of the Supreme Court of Appeal is binding on all lower courts, the decision in the \textit{Oakdene} case\textsuperscript{172} will be followed by all high courts and will go a long way towards achieving some level of certainty on business rescue proceedings. The importance of this decision was also emphasised by Loubser when she expressed that it would be “disastrous for the new procedure” if the same high threshold test of “reasonable probability” used in a judicial management order were to be implemented again on this procedure.\textsuperscript{173}

Creditors as affected parties are bound to oppose any application for business rescue and will not vote in favour of the plan when they see no prospect of a company being rescued because

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\textsuperscript{164} \textit{Koen case} (n 160) par 23.
\textsuperscript{165} \textit{AG Petzetakis case} (n 62).
\textsuperscript{166} \textit{AG Petzetakis case} (n 62) par 19 and 34.
\textsuperscript{167} \textit{Oakdene Square Properties case} (n 7).
\textsuperscript{168} \textit{Oakdene Square Properties case} (n 7) par 29–31.
\textsuperscript{169} \textit{Southern Palace case} (n 52).
\textsuperscript{170} \textit{Oakdene Square Properties case} (n 7) par 31. See also Meskin et al (n 24) 465.
\textsuperscript{171} Bradstreet (n 75) 47.
\textsuperscript{172} \textit{Oakdene Square Properties case} (n 7).
\textsuperscript{173} \textit{Oakdene Square Properties case} (n 7) par 18.
of the lack of reasonable grounds. It was said in the case of Oakdene that the intention of creditors to oppose a plan was something that could not be ignored in principle:

As I see it, the applicant for business rescue is bound to establish reasonable grounds for the prospect of rescuing the company. If the majority creditors declare that they will oppose any business rescue scheme based on those grounds, I see no reason why that proclaimed opposition should be ignored, unless, of course, that attitude can be said to be unreasonable or mala fide.174

In the Newcity case175 CCBC also opposed the application and vowed never to vote in favour of the plan as this would result in an increase in debt; the court also seemed to have considered that opposition.

The Solar Spectrum case176 is of interest for a few reasons. Besides being one of only a handful of cases in which the applicant successfully applied for business rescue, it is also the first case which was brought by the employees of a company. The judgment gives valuable insight into the factual detail required in proving a reasonable prospect of rescuing a company and how courts could be expected to approach the balancing of employees’ interests against the interests of creditors. The court held that the use of the words “reasonable prospect” instead of “probability” (as was the case in the previous Act) suggested that the legislature required the application of a less stringent test than had been the case in an application for judicial management.177 To determine whether there was a reasonable prospect of recovery, the court referred to the test applied in the Southern Palace case178 which required the applicant to present evidence in relation to the cause of the failure of the company and also to propose an appropriate remedy or corrective action. The court should also be convinced of indicators which suggest a reasonable prospect for recovery obtainable from concrete and objective ascertainable facts.179 The court held further that the applicant should place determinable facts before the court to show that the future prospects of rescuing the company appear to be reasonable in light of the circumstances.180 Business rescue in this case was granted.181 Swart agrees that all categories of affected persons will not be equally privy to information of the company relevant

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174 Oakdene Square Properties case (n 7) par 38.
175 Newcity case (n 2) par 9.
176 Solar Spectrum case (n 131).
177 Solar Spectrum case (n 131) par 10.
178 Southern Palace case (n 52).
179 Solar Spectrum case (n 131) par 10 and 15. See also Southern Palace case (n 52) par 24.
180 Solar Spectrum case (n 131) par 34.
181 Solar Spectrum case (n 131) par 38.
to an application, but what is important is to determine if an application complies with the requirements set out in section 131(4) of the Act, otherwise it will not qualify.182

It is clear that the level of proof required by the courts to show that there is a reasonable prospect of rescue has been a common issue under scrutiny. In the case of *Nedbank Ltd v Bestvest; Essa and Another v Bestvest*183 the judge was of the view that the bar should not be placed at such a height that there is only a thin line of success.184 In the case of *Welman v Marcelle Props*185 the success of the close corporation depended on the applicant’s belief that “hope springs eternal”. However, courts faced with rescue applications must bear in mind the interests of other affected persons such as shareholders, whose interest must be taken into account and be respected. Therefore the judge concluded in remarks 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 application, in these circumstances, would be to subvert the purposes of the Act and disregard the interest of other stakeholders. It is preferable to have the Close Corporations liquidated than to place them under supervision hoping that business proceedings would cure the inevitable.186

In terms of section 132(3) of the Act, the business rescue proceedings end within a period of three months unless the court extends it. In the matter under discussion, it was undisputed that for the next six months, it would be unlikely that the close corporation would be able to pay all of its debts as they became due. Although it appeared that the arrears were settled and there were debit orders in place, no concrete facts were placed before the court to determine the source and extent of the debit orders.187

In the application for business rescue in the *Gormley* case188 Traverso DJP made it clear that where there is need for a moratorium and the realisation of assets over a three- to five-year period, such a prospect cannot be deemed to fall within the object contained in section 128(a)(iii) of the Act. The judge indicated that there were no facts brought forward by the

184 *Nedbank* case (n 183) par 38.  
186 *Welman* case (n 185) par 26, 27 and 29.  
187 Section 132(3) of the Companies Act. See also *Welman* case (n 185) par 29.  
188 *Gormley* case (n 109).
applicant but only “generalisations”, and that there was a lack of information needed to prove the recovery requirement for successful business rescue proceedings.\textsuperscript{189} Stelzner JA in Zoneska Investments (Pty) Ltd \textit{v} Midnight Storm Investments\textsuperscript{190} explained that the applicant need not supply specific details,\textsuperscript{191} but at the same time, information before the court should not be comprised of mere “speculative suggestions”.\textsuperscript{192} Although Stelzner JA acknowledged the fact that “there cannot be a checklist approach to business rescue applications”\textsuperscript{193} he emphasised the need for satisfactory facts to convince the court to decide in favour of the supervision, including “an assessment of the practical feasibility of the plan”.\textsuperscript{194} It seems that Stelzner JA followed the same direction as that followed by Eloff JA in the Southern Palace case,\textsuperscript{195} where the information needed in a business rescue application was already treated as information needed for the plan, something which has since been rejected by other judges. In conclusion, regarding the provisions of the Act, Loubser went on to criticise them by saying the following:

The many unclear, confusing and sometimes alarming provisions regulating the business rescue proceedings in the Companies Act of 2008 will certainly not assist in making the procedure more acceptable or successful. Therefore, it is hoped that the legislature will recognise the urgent need to clarify, rectify or replace these provisions as soon as possible.\textsuperscript{196}

In the case of \textit{Van Niekerk v Seriso}\textsuperscript{197} the court concluded that there were reasonable grounds to believe that the practitioner would be able to raise a further bond to pay the bank amount which was due to it to enable the continuation of business or alternatively to sell the property in order to satisfy its debts.\textsuperscript{198} Bradstreet’s conclusion was that despite potential problems, the mechanism has to be given a green light in terms of its effectiveness. But if the company becomes financially distressed because of internal factors, the mechanism will obviously be less effective and the chances will be much lower that it will get back to a solvent state again.

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\textsuperscript{189} Gormley case (n 109) par 12.
\textsuperscript{190} Zoneska Investments case (n 129).
\textsuperscript{191} Zoneska Investments case (n 129) par 48.
\textsuperscript{192} Zoneska Investments case (n 129) par 47.
\textsuperscript{193} Zoneska Investments case (n 129) par 53.
\textsuperscript{194} Zoneska Investments case (n 129) par 51.
\textsuperscript{195} Southern Palace case (n 52).
\textsuperscript{196} Loubser “The business rescue proceedings in the Companies Act of 2008: concerns and questions (Part 2)” 2010 \textit{TSAR} 689 701.
\textsuperscript{197} 952/11, 23929/11 [2012] ZAWCHC 63 (20 March 2012).
\textsuperscript{198} Van Niekerk case (n 197) par 33.
\end{flushright}
Chances of recovery have probably little to do with a management change but more with the practitioner’s competence and how he or she will implement the plan.\textsuperscript{199}

In summary, the above discussion has shown that the South African courts are implementing a realistic approach which is not open to vague and mere speculative suggestions as to the prospects of restoring a sinking company to a position of solvency. Only applicants who have shown the court that there are prospects based on reasonable grounds for the company and a better return to creditors, can succeed. Although the court in \textit{Southern Palace} \textsuperscript{200} held that even if a lower threshold is satisfied, the rescue plan will not succeed if it does not address the cause of the demise or failure of the company’s business and offers a remedy for this that has a reasonable prospect of being sustainable, the courts should give due weight to the legislative preference for rescuing an ailing company if it deems it possible and reasonable.\textsuperscript{201}

7. Discussion of the decision to liquidate Crystal Lagoon

The company Crystal Lagoon, which had been in business rescue before, had no hope of justifying another rescue. Finality was the best option to be offered to the parties. A liquidator could sell the hotel property which would enable CCBC, as a secured creditor, to receive the debt due to it.\textsuperscript{202} Moreover, the business rescue practitioner himself lacked competence. He was supposed to be held to high professional and ethical standards because he was the “weakest link” for creditors and is the most likely object of litigation. He failed to procure a plan and sought an adjustment and extension of time several times. He also relied on “expressions of interest” which at that time were not viable.\textsuperscript{203}

If business rescue was granted the moratorium, with its disadvantages for creditors, would be automatically applied. Since the Newcity Group claimed that the hotel was in its so-called “ramp-up phase” which would last for about four years, this implies that rescue proceedings were not going to be completed or even partially completed within a reasonable time. The company clearly was in serious financial difficulties which it could not escape.\textsuperscript{204} Further, a guarantee or a surety in respect of its liabilities in favour of any other person was not going to be enforceable, unless the court were to grant leave on its own terms. This would mean that the

\textsuperscript{199} Bradstreet (n 34) 380.
\textsuperscript{200} \textit{Southern Palace} case (n 52).
\textsuperscript{201} \textit{Southern Palace} case (n 52) par 22.
\textsuperscript{202} \textit{Newcity} case (n 2) par 2.
\textsuperscript{203} \textit{Newcity} case (n 2) par 6 and 9.
\textsuperscript{204} \textit{Newcity} case (n 2) par 12.
security for the loan which CCBC held, including a deed of suretyship from Cohen, and a mortgage bond registered over the hotel property, would not be enforceable against the Newcity Group.\textsuperscript{205}

Another reason for not granting business rescue is that it would bring in more delays, costs and litigation. The business rescue practitioner would have to be paid, together with some other amounts of interest that had already accrued. There were also costs to be paid in terms of the Extrabold lease agreement together with the attorneys’ and directors’ fees. The replacement of Rezidor management would probably attract a lawsuit. In conclusion, this showed that the business rescue plan was unlikely to achieve anything more than a prolonged agony. A liquidator would only need to gather the company’s property and then liquidate the same, at a far lower cost.\textsuperscript{206}

Crystal Lagoon was in debt arrears and it lacked financial support; in addition CCBC withdrew its loan facility. The “third-party offers” mentioned were not commercially viable. The Rezidor agreement which was expected to concluded. The court concluded that the company was hopelessly insolvent. It was unable to raise more capital since they supplied only a vague statement of undefined parties’ intentions, and it had not been able to pay its debt for a considerable time. Liquidation would put an end to this hopeless situation considering the circumstances under which the company was operating its business.\textsuperscript{207} It is plain from the wording of the relevant provisions in the Act that a court may not grant an application for business rescue unless there is a reasonable prospect for rescuing the company, or when otherwise just and equitable for financial reasons.\textsuperscript{208}

The company was financially distressed as could be deducted from the non-payment of amounts due in respect of employment matters. Crystal Lagoon failed to pay its management agency, Rezidor, in over three years.\textsuperscript{209} Liquidation proved to be able to provide a payment to CCBC which is over and above of what it could expect if the company were put under business rescue. The company was supposed to show a factual foundation for the existence of a prospect based on reasonable grounds that the desired object can be achieved.\textsuperscript{210} All that was alleged in Newcity Group’s affidavits was that the costs of liquidation would exceed those incurred in

\textsuperscript{205} Rushworth (n 47) 384. See also \textit{Newcity} case (n 2) par 3.
\textsuperscript{206} \textit{Newcity} case (n 2) par 19, 21 and 23.
\textsuperscript{207} \textit{Newcity} case (n 2) par 18 and 19. See also \textit{DH Brothers} case (n 82) par 12.
\textsuperscript{208} Section 131(4) of the Companies Act 71 of 2008.
\textsuperscript{209} Loubser (n 116) 511. See also \textit{Newcity} case (n 2) par 20.
\textsuperscript{210} \textit{Propspec Investments} case (n 10) par 11.
business rescue; yet the “mere savings on the costs of the winding-up process can hardly justify the separate institution of business rescue”. But even if it alleged such, its business rescue plan did not even show that such a saving was possible.\textsuperscript{211}

In interpreting the goals of the business rescue procedure as described in section 128(1)(b), the court found that Newcity Group had failed to establish a prospect based on reasonable grounds that business rescue would return Crystal Lagoon to solvency or provide a better deal for its creditors and sole shareholder than what they would receive through liquidation. Conclusively, a liquidator would be able to sell the hotel as a going concern and thereby yield a better result for all concerned than when placing it under business rescue.\textsuperscript{212}

To conclude the discussion of this very interesting case, it has to be pointed out that the courts have, constantly dismissed an application for business rescue and ordered liquidation instead in cases where a proper and objective rescue plan which demonstrate a reasonable prospects for rescuing the company could not be provided.\textsuperscript{213}

8. Conclusion

The circumstances in Newcity Group (Pty) Limited \textit{v} Allan David Pellow\textsuperscript{214} prove that the courts, by setting the benchmark on factual, material and objective grounds, are not allowing frivolous applications to succeed. This has helped in preventing business rescue proceedings from being used as a quick fix to avoid debt repayment and to ensure that business rescue is utilised for its proper purpose. The test for achieving the minimum requirements, if not proved to the court, will continue to haunt the success of business rescue proceedings. Parties are required to establish and provide prospects based on objectively reasonable grounds. Should an applicant fail to provide information on such prospects, the application is doomed to fail. The case is useful in that it provides an illustration of how creditors’ interests will be weighed against the interests of the financially distressed company and provides a comprehensive model for understanding the new position of creditors in the wake of the shift towards a business rescue model based on creditor-friendliness.

\textsuperscript{211} Oakdene Square Properties case (n 75). See also Newcity case (n 2) par 21.
\textsuperscript{212} Newcity case (n 2) par 23.
\textsuperscript{213} Braatvedt “A new direction” \textit{Without Prejudice} (November 2012) 22.
\textsuperscript{214} Newcity case (n 2).
The right of creditors to liquidation is not in any way undermined by the new business rescue procedure as it is also provided for in section 131(4)(b) of the Companies Act. The definition of business rescue in section 128(1)(b) of the Act also seems to protect and promote the interests of creditors as a secondary goal – however, it is still an alternative goal – by allowing them to dominate the area when it comes to protecting their own interests. If this should imply that liquidation is in their best interest, the court has every discretion to refuse to grant the order to commence business rescue proceedings, as it has done in the case of Newcity.

In conclusion, it is clear that the “monstrous giant” is not a giant at all but merely windmills, big, sturdy harmless windmills performing a useful and necessary function in the community, which should not be fought and eliminated.\textsuperscript{215} To avoid Chapter 6 provisions from becoming ineffective in the same way as its predecessor, it is submitted that the approach as set out in the Propspec Investment case\textsuperscript{216} decision is a constructive approach to the difficulties that obstruct the road to a successful business rescue application.

In my view this case produced a just result. That is partially because the judgment clearly shows that courts, as much as they share and understand the imperatives of business rescue, will not lightly entertain and grant such applications unless there is a solid and firm basis established and partly because there was no true basis to ground a reasonable prospect of rescuing the company. Even though the meaning of a “reasonable prospect” is still not fully clarified, at least recent court judgments have proven to have lowered the bar, and a more versatile approach has been advocated that will be used as precedence to produce a swift and easy determination process without the bar being placed too high. But either way, the courts have proven that “business rescue proceedings are not for the terminally ill. Nor are they for the chronically ill. They are for ailing companies, which, given time, will be rescued and become solvent.”\textsuperscript{217}

\textsuperscript{215} Loubser (n 46) 437.
\textsuperscript{216} Propspec Investment case (n 10)
\textsuperscript{217} Welman case (n 185) par 26, 27 and 29.
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