CASE LAW: 2008 COMPANIES ACT

BUSINESS RESCUE PROCEEDINGS

Interests of creditors

Swart v Beagles Run Investment 25 (Pty) Ltd 2011 (5) SA 422 (GNP) was the first case to deal with chapter 6 of the 2008 Companies Act. This case deals with a business rescue application in terms of s 131 of the 2008 Companies Act. In terms of s131 an affected person can apply to court for an order placing a company under supervision and commence with business rescue proceedings. The requirements to place a company under business rescue are also listed in s 131(4)(*a*)(i) - (ii) and include that the court must be satisfied that the company is financially distressed, failed to pay over any amount in terms of an employment obligation or it is just and equitable to do so for financial reasons, and there is a reasonable prospect of rescuing the company.

In this case the sole director and shareholder of the respondent, a chartering business dealing in exotic wildlife species, applied for an order to place the company in business rescue based on the fact that the respondent was financially distressed as envisaged in s 128(*f*) of the 2008 Companies Act (para [10]). A number of creditors opposed the application indicating that it abused the process and that it is an attempt by the company to avoid or postpone the payment of debts (para [12]). The creditors also alleged that the company had been trading recklessly for some time.

The court indicated that business rescue proceedings are new in terms of the 2008 Companies Act. The court held that the purpose of chapter 6 is to assist a financially distressed company by means of a business rescue plan in order to maximise the possibility of the company continuing on a solvent basis, or to achieve a better return for its shareholders and creditors compared to a liquidation (para [18]). The court held that when weighing up the interests of the company and the creditors those of the creditors should prevail (para [41]). To determine whether the applicant complied with the requirements listed in s 131, mentioned above, the court stated that the business rescue proceedings are new and there is no previous case law on the matter to consider (para [23]). The court then turned to the previous 'judicial management provisions', especially regarding the meaning of 'successful concern' (para [25]). In other words, it must be reasonably probable that the company is viable and capable of ultimate solvency, and that it will, within a reasonable time, become a 'successful concern' and yield a return for its shareholders and creditors (para [25]).

It is argued in *Henochsberg* op cit 446 that it is unfortunate that the court compared this new proceeding with the previous judicial management provisions, as the 2008 Companies Act makes no reference to 'successful concern' and it is also not a requirement in terms of the business rescue proceedings. We agree with this submission. One of the reasons advanced by commentators for the failure of judicial management as a business rescue procedure was that the onus of showing that a company could be turned into a 'successful concern' was too great (see Anneli Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (unpublished LLD Thesis, 2010, Unisa) 22 – 24). It is an express purpose of the Companies Act 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' (s 7(*k*)). Coupled with the purposive interpretation provisions in ss 5(1) and 158, a return to the position where business rescue is seen as an extraordinary remedy (*De Jager v Karoo Koeldranke en Roomys (Edms) Bpk* 1956 (3) SA 594 (C) at 602D - F; *Porterstraat 69 Eiendomme (Pty) Ltd v P A Venter Worcester (Pty) Ltd* 2000 (4) SA 598 (C)

at 615E - H; *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd (FBC Fidelity Bank Ltd (under Curatorship), Intervening)* 2001 (2) SA 727 (C) at 744J -746J), as was the case with judicial management, seems out of place. While the interests of creditors are certainly important, there is nothing in the procedure to indicate that their interests should be more important than those of other stakeholders. The comments of the court in *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 369 Ltd & others* (para [21], see the discussion below) is therefore preferred.

The court dismissed the application with costs and held that it was not indicated that the granting of a business rescue will place the creditors in a better position than what they would be should it be wound-up (para [42]). It is common cause that the respondent was financially distressed, but the applicant did nothing about it, refused to sell any assets, incurred further debts or making loans (paras [38], [40]). The applicant, as sole director and shareholder was therefore the only interested party in the continuation of the respondent as a going concern, but he carried on business in a reckless manner. He also did not give any detail regarding the loan of an amount in excess of R72 000 000 to an entity of which he was the sole director (para [39]).

It is argued in *Henochsberg* op cit 446 that the court must be applauded for turning down the application on the basis that it amounted to an abuse of the process. It is also interesting to note that the court did not grant a liquidation order, despite it having the power to do so and based on the fact that a winding-up order was pending in the same court.

Costs of business rescue proceedings, notification and leave of the court by an affected party

Reference should also be made to the case of *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd and Others* 2011 (5) SA 600 (WCC). The court did not deal with the merits of the case as it was a clear case for granting relief in terms of s 131(4)(*a*) and the order carried significant support among the shareholders. The court did, however, note a few other features of the case as the business rescue procedure is still novel in South Africa (para [11]).

First the court dealt with the issue of costs of a business rescue application. The 2008 Companies Act contains no express provision dealing with costs incurred by an applicant in proceedings under s 131. It seems, however, that preference is given to the business rescue practitioner's remuneration and expenses and to 'other claims arising out of the costs of the business rescue proceedings' (see s 135(3)). The mere absence of an express provision for the court to make a costs order does not mean that the court has no such power (para [5]). An inability to recover reasonable costs would serve as a disincentive for affected persons to bring proceedings under s 131 (para [6]). The court's inherent jurisdiction in regard to costs will therefore apply to proceedings under s 131.

The court also dealt with the issue of notification in the prescribed manner. In terms of s 131(2) the applicant must serve a copy of the application on the company and the Commission and notify each affected person of the application in the prescribed manner. Affected persons include creditors, shareholders, trade unions and employees who are not represented by a trade union. There was due service on the company and the Commission when the application was launched on 27 June 2011, but no notification was given to the affected persons. On 19 July 2011 the creditors were informed via email and the shareholders by way of an announcement placed on SENS, which set out the nature of the proceedings and the relief sought. The application was enrolled for hearing on 27 July 2011.

Notification must be in 'the prescribed manner'. Regulation 124 states that the applicant must deliver a copy of the court application to each affected person as prescribed in Regulation 7. Section 131(2), however, only refers to notification and not delivery. The court therefore held that Regulation 124 may require more than what may lawfully be prescribed in terms of s 131(2) (para [16]). Be that as it may, in this matter there was a pending liquidation application rendering the application relatively urgent and the court held that notification via SENS to the shareholders should be sufficient (para [17]). The notification via email to the creditors was not problematic as it is allowed as a permitted method of notification in terms of Table CR3 (para [14]). The court did warn that in future advanced authority from the court for substituted service would be advised (para [18]).

Lastly, with regard to intervention by an affected party, each affected party has the right to participate in the hearing of an application in terms of s 131. The affected party has the right to intervene and does not have to apply for leave to intervene (para [21]). Courts would need to regulate the procedure should affected parties want to file affidavits, to ensure fairness to all parties involved. (See *Henochsberg* op cit 452, 458, 464 for a separate discussion of this case.)

In *Engen Petroleum Ltd v Multi Waste (Pty) Ltd* (GSJ 23 September 2011 (case 33410/11), unreported) the court also took the view that an affected party does not require leave of the court to intervene (para [30]). The court did however indicate that such leave may be necessary as a procedural requirement and referred to *Fullard v Fullard* 1979 (1) SA 368 (T) and *Shapiro v South African Recording Rights Association Limited (Galeta Intervening)* 2008 (4) SA 145 (W). The *Engen* case was an urgent application brought by an intervening creditor, Engen, who wanted to oppose the granting of an order for the placement of two companies under supervision and to commence business rescue proceedings in terms of s 131(1) of the 2008 Companies Act. A number of procedural irregularities were present in the case, such as the failure to comply with the service and notice requirements as laid down in the Act (para [11]). The application to commence business rescue proceedings in terms of s 131(1) of the 2008 Companies Act was instituted on an ex parte basis. This was done by various employees, the sole shareholder and director of the companies as affected persons.

The court held that an ex parte application or an application using the short form notice of motion (Form 2) is used either because it is not necessary to give notice to the respondent or because the relief claimed is not final in nature. The court held that for an application in terms of s 131(1) the long form notice of motion must be used (para [14]). The court said that if the legislature intended that an ex parte application could be used it would have been expressly indicated (para [16]).

An application to place a company under supervision in terms of s 131(1) concerns a document that initiates proceedings that must be served by the sheriff. The application must be served on the Commission (see Rule 4 of the Uniform Rules) and a copy cannot merely be left at the offices of the Commission, as was the case here (para [18]).

The case also dealt with 'notification' in the 'prescribed manner'. An applicant must satisfy the court that all reasonable steps have been taken to notify all affected persons by delivering the application in terms of Regulation 7. Where this is impossible the applicant must apply to the High Court for an order of substituted service. At the least the applicant must demonstrate that all reasonable steps were taken to establish the identity of the affected persons and their addresses (para [24]). On the facts there was not proper compliance with the notification requirements (para [26]).

Owing to all the discussed irregularities the application was dismissed. The application also did not succeed as the liquidation of more than one company cannot be sought in a single application, unless there is a complete identity of interests. This was not the case.

The position of sureties during business rescue proceedings

In *Investec Bank Ltd v Bruyns* (WCC 14 November 2011 (case 19449/11), unreported) the plaintiff asked for summary judgment against the defendant based on various claims. The first was for money lent to the defendant on his personal bank account. The other claims were based on suretyships, which the defendant executed in favour of the plaintiff for the debts of Golf Development International Holdings (Pty) Ltd and Winners-Circle 111 (Pty) Ltd, both companies in liquidation.

It is the latter claims that were relevant from a business rescue perspective. The defendant's opposition rests upon the fact that applications have been issued to place the two companies under supervision and to commence business rescue proceedings in terms of s 131(1) of the 2008 Companies Act. This is possible even though the two companies were already in liquidation. The institution of the business rescue application therefore caused, according to the defendant, business rescue proceedings in respect of the companies to commence meaning that summary judgment against the defendant as surety should be refused. The defendant argued the following: s 133(2) prohibits claims against parties who have executed suretyships in favour of a company undergoing business rescue proceedings. Furthermore, as surety, the defendant can also claim the benefit of the moratorium afforded to companies during business rescue proceedings (see s 133(1)). Lastly, the amount of the principal debt is uncertain as it may be compromised in terms of an approved business rescue plan (para [11]).

The court held that s 133(1) is a general provision and affords the company protection against legal action on claims in general, except with the written consent of the business rescue practitioner or with leave of the court. Section 133(2) deals specifically with suretyships and guarantees when leave of the court, and not permission from the business rescue practitioner, will be necessary to enforce claims against a company (para [16]). The court therefore distinguished between a general moratorium (in s 133(1)) and the specific provision relating to sureties and guarantees (in s 133(2)). Section 133(2) will apply to the exclusion of s 133(1) regarding claims based on suretyships and guarantees (para [16]).

The court held further that the statutory moratorium in s 133(1) is a defence *in personam* and would not have the effect of discharging the obligations of the principal debtor (para [18]). The statutory moratorium in favour of the two companies, as embedded in s 133(1), will therefore not benefit the defendant (para [19]) as it is a personal benefit or privilege in favour of the company. Section 133(2) also clearly refers to a surety *by the company* and to its enforcement by another person *against the company* (para [16]).

It is clear from this judgment that sureties and guarantors cannot benefit from the protection awarded to companies in terms of the 2008 Companies Act during business recue proceedings. The summary judgment was therefore granted.

Jurisdiction to place a company under supervision for business rescue purposes

Sibakhulu Construction (Pty) Ltd v Wedgewood Village Gold Country Estate (Pty) Ltd & others (WCC 16 November 2011(case 27956/2010), unreported) considered which

High Court has jurisdiction to hear applications for winding-up and the commencement of business rescue proceedings in terms of the 2008 Companies Act.

The applicant, and later Nedbank intervening, applied for the winding-up of the first respondent ('Wedgewood'). However, the hearing for winding-up could not proceed, because two owners of residential property purchased from Wedgewood ('the Koens') applied for the commencement of business rescue proceedings in the Port Elizabeth High Court. In terms of s 131(6) of the Act, liquidation proceedings are suspended when an application for commencement of business rescue proceedings is made, until such time as the court has adjudicated upon the application, or the business rescue proceedings have ended. However, Wedgewood's registered office was in Cape Town. The applicants argued that the Koens lodged their application in a court that had no jurisdiction to hear the matter, and that s 131(6) therefore did not apply to their proceedings.

Section 131(1) requires an affected person to apply to *a court* for the commencement of business rescue proceedings. Section 128(1)(*e*) attempts to provide a definition of the meaning of 'court' for purposes of business rescue proceedings. However, this provision is of little help, since it simply refers to 'the High Court that has jurisdiction over the matter'. It appears from this provision as if only one High Court will have jurisdiction to hear a matter dealing with business rescue proceedings (para [9]).

Section 12(1) of the 1973 Companies Act provided that the jurisdiction of a court with regards to a company had to be determined with reference either to its registered office or its main place of business. The 2008 Companies Act repealed this provision and does not contain any similar provision dealing with jurisdiction. The common law will therefore have to relive, unless a proper reading of the Act leads to a different conclusion (para [11]). The court refers to a passage from *TW Beckett & Co Ltd v H Kroomer Ltd* 1912 AD 324 at 334 where the court held that where a company had more than one place of business, it is resident where its general administration is located. However, the later decision of *Dairy Board v John T Rennie & Co (Pty) Ltd* (1976) 3 SA 768 (W), confirmed in *Bisonboard Ltd v K Braun Woodworking Machinery (Pty)* Ltd 1991 (1) SA 482 (A), held that there may be concurrent jurisdiction between the High Court where the company had its main business operations and the High Court where its registered office was situated (paras [14] and [15]). The court therefore had to consider whether s 23 of the 2008 Companies Act, dealing with the registered office of a company, changed the position as it was in terms of the previous Companies Act (para [16]).

The court held that the principal difference between the provisions in s 23 and its predecessors is that it requires the company to have as its registered office, its *principal office* (para [19]). The court comes to the conclusion, when considering the documents that must be kept at the registered office, that the registered office of a company must be the centre of its administrative business, which was described as a company's 'principal place of business' in *TW Beckett & Co* (supra). This leads the court to conclude that the new Act requires a company's registered office and its main place of business to be the same place (para [19]).

The court went on to conclude that also the objectives of the Act stated in s 7(*k*) and (*l*) support the interpretation that only one court should have jurisdiction to consider matters regarding the winding-up and business rescue proceedings of a company (paras [23] and [24]).

It was therefore held that the Koens did not institute their proceedings in a court having jurisdiction, which meant that s 131(6) did not apply to the applicants' proceedings (para [27]). The court was prima facie convinced that the applicants had grounds for the

winding-up of the company, but nevertheless found it proper to afford the Koens the opportunity to transfer their proceedings to the proper forum for adjudication (para [33]). The court's decision in the application for business rescue by the Koens is considered immediately hereafter.

Requirements for the basis of an application for the commencement of business rescue proceedings

The Koens transferred their application to the Cape High Court (*Koen & another v Wedgewood Village Golf and Country Estate (Pty) Ltd & others* (WCC 9 December 2011 (case 24850/11), unreported), which had the effect of suspending the application for winding-up in terms of s 131(1) (see the discussion immediately above on the proceedings that led to the transfer of the application). The essence of the application for the commencement of business rescue proceedings was that there was a prospect that an unnamed investor might take over the business opportunity that Wedgewood presented. To this end they moved for a postponement of their application (para [7]).

The court was not persuaded to postpone the application for the following reasons: the winding-up was pending since December 2010; the company ceased operations in 2009; interest was accruing against the company at a significant rate; even if a winding-up order was granted, an affected person could still intervene to convince the court to suspend the liquidation of the company when the prospective investment opportunity manifested (para [8]). The court was also not swayed by an argument that the investor would be less inclined to pursue the opportunity if a winding-up order was granted (para [9]). It seemed clear to the court that such an investor must be interested in the opportunity and not in the company as such.

The application for commencement of business rescue proceedings was therefore considered. The court held that an applicant must show a court that there is a reasonable prospect that the company could be rescued (para [17]). 'Rescue' in this context carries a wider meaning that immediate apparent. It does not only include the continued existence of the company, but also the prospect of realising a greater value for the creditors of the company than would be available if the company were immediately wound up (see s 128(1)(*b*)).

The court held that in order to succeed with an application, the applicant must already place before it 'a cogent evidential foundation to support the existence of a reasonable prospect that the [company will be rescued]' (para [17]). There must at least be enough facts before the court to assist it to hold that the business rescue practitioner will have a viable task, or that an investigation by such a practitioner may be warranted. The court agreed with the observations made in *Southern Palace* (infra at para [24]) in this regard. Vague averments and speculation will not suffice to provide a proper basis for the commencement of business rescue proceedings (para [18]).

In the case under consideration, evidence before the court showed that an estimated R 81 million would be needed to complete Wedgewood. However, the application did not provide any details of the identity of the prospective investor, its means or the terms of its investment proposal (para [23]). This falls substantially short of what is required for a successful application for the commencement of business rescue proceedings. The court also had reservations about whether the Koens were 'affected persons' as defined in the Act (s 128(1)(*a*)), but did not need to consider this in any detail. The application to commence business rescue proceedings was dismissed.

An application to commence business rescue proceedings also formed the subject of the decision in *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 369 Ltd & others* (WCC 25 November 2011 (case 15155/11), unreported). In this case the respondent company ('Midnight Storm') formed part of a group of companies that was in involved in property development. Two of the companies in the group raised funds from the public through debentures to finance the operations of the other group companies. These two companies were put under management in terms of s 84 of the Banks Act 90 of 1994 in order to repay the funds so raised to the members of the public. This led operations of the companies in the greater group coming to a halt. Most of these companies were either in the process of winding-up or placed under voluntary business rescue.

Midnight Storm was used for the construction of a hotel in Blaauwberg. Construction on the hotel had ceased and one of its creditors applied for the winding-up of the company. The application for winding-up was intervened by another creditor, who applied for the company to commence business rescue proceedings.

The contents of the application for business rescue were described by the court as 'extremely terse, vague and uninformative' (para [15]). Essentially, the applicant and one Mr Hassim hoped to secure further investment that could save Midnight Storm and repay all its creditors. However, it was shown by the parties opposing the application that Midnight Storm owed R415 million to its investment companies, R52 million to its bondholder and that it would take a further estimated R200 million to complete the project.

The court considered the meaning of 'reasonable prospect' for rescuing a company in s 134(1) of the 2008 Companies Act (para [20]). The court is of the opinion that this term requires something less than what was required in s 427(1) of the 1973 Companies Act for the commencement of judicial management, where a 'reasonable probability' was required (para [21]). The court further acknowledged that judicial management was seen as an extraordinary remedy and that it was seen as a creditor's prima facie right to commence liquidation. Contrary to this approach, the 2008 Companies Act prefers business rescue to liquidation.

Notwithstanding this approach, the court still retains discretion not to allow the commencement of business rescue (para [22]). The court considered it significant that the board of directors of Midnight Storm did not initiate the proceedings (para [23]). Furthermore, the applicant did not present the court with a concrete plan for consideration. The court mentioned the following 'concrete and objectively ascertainable details going beyond mere speculation' that could be included in an application for commencement of business rescue (para [24]):

- The likely costs of enabling the company to commence or resume its business;
- The likely availability of cash resources for it to meet its trade commitments, and if these would come from loans, the details of such lending;
- The availability of other resources, such as labour and raw materials;
- Reasons why it is suggested that *the proposed business plan* will have a reasonable prospect of success.

It is clear from the judgment in general that the court needed this information to be able to determine whether the application was an attempt to stall the inevitable insolvent winding-up of the company without any benefit to its creditors, or whether it had a proper substratum for the commencement of the proceedings. However, if the approach of the court is followed in future judgments, it is evident that applicants for the commencement of business rescue will already need some form of concrete plan before the business rescue practitioner is appointed.

This seems contrary to the direct duty placed upon the appointed business rescue practitioner in s 140(1)(*d*) to develop and, if approved by the affected persons, implement a business rescue plan.

On the other hand, since the applicants for the commencement of business rescue proceedings will nominate the person to be appointed as the business rescue practitioner (s 131(5)) and since they will usually form part of the group of affected persons that will have to consent to the business rescue plan (s 152), this might be less of a concern in practice. However, the fact remains that the business rescue practitioner is not bound to adopt the preliminary proposals brought before court during the application of commencement of business rescue proceedings. Furthermore, the practitioner's duty is towards the company and not towards the interests of any specific affected person (s 140(3)). It is important that applicants for the commencement of business rescue proceedings not be misled by the comments of the court above into thinking otherwise.

In the case under discussion the court was not convinced by the vague and speculative nature of the application. It accordingly dismissed the application and granted the order for winding-up.