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The advent of the new Companies Act 71 of 2008 (the Act) brought with it a shift from a creditor-protectionist society towards a business rescue model that is debtor-protectionist. In consequence, there has been a swarm of applications taking advantage and exploiting this new scheme. This shift has unfortunately led to considerable abuse of the business rescue procedure.

The courts have been grappling with the abuse of the business rescue system, where some companies have simply been looking for a debt holiday. The abuse of the business rescue procedure was very evident in the case of *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd (609/2012) [2013] ZASCA 68 (27 May 2013)*, the first SCA case on business rescue. This case raised the important question about where the division lies between use and abuse of the procedure.

The facts of the Oakdene case are well known. The court held that it is clear from the definition of “business rescue” in section 128(1)(b) of the Act that the business rescue plan contemplates a primary and a secondary goal. The term “business rescue” was held to incorporate not only plans to restore the company to solvency, but also plans that aim solely at securing and facilitating a better return for the creditors or shareholders of the company than would result from immediate liquidation. Business rescue may be harnessed solely to pursue the secondary goal.

The pertinent question was then whether the company had established a reasonable prospect for ensuring a better return for Nedbank. Brand AJA held that the company’s proposal that the business rescue practitioner rather than the liquidator should sell the property consisted of no more than an alternative, informal kind of winding-up of the company. He ruled that business rescue was not intended to achieve a winding-up of a company to avoid the consequences of liquidation proceedings. Other sinister aspects in the management of the company’s affairs further persuaded the court that liquidation proceedings were better suited and would in fact be more advantageous to creditors and shareholders.

The SCA upheld the decision of the court a quo that business rescue proceedings were not appropriate and the appeal was dismissed in favour of Nedbank.

The abuse of business rescue

Chapter 6 of the Act affords a debtor company various procedural and substantive protections and advantages during the business rescue procedure. The low barriers to entry coupled with the tempting array of advantages and protections have unfortunately opened the procedure to abuse.

Business rescue proceedings against a company may be commenced by way of either a resolution adopted by the company's board of directors or a court order. The threshold for passing the resolution is merely that the board needs reasonable grounds to believe the company is financially distressed and that there is a reasonable prospect of rescuing it.

Currently there is no legislated requirement for the board of directors to justify their bare assertion that reasonable prospects exist. The procedural and financial barriers to entry are very low, thereby facilitating the abuse of the process. Shareholder approval is not required, nor prior notice to creditors, and it is also not necessary to apply to court. Due to the fact that it's so easy to start business rescue proceedings, applicants have started the process even when they are well aware that there is no business to rescue and that a better return for creditors will not be obtained. In many instances, resolutions passed for business rescue are nothing more than attempts to delay the ultimate demise of companies that could clearly not pay their debts and to buy more time from creditors who are threatening liquidation.

Moratorium on creditor's claims

One of the drastic consequences of commencing business rescue proceedings is the immediate moratorium of creditors' claims against the company, which lasts for the duration of the business rescue proceedings. Not only may execution proceedings or enforcement action by creditors against the financially distressed company not be initiated, if such actions had been underway they may not be continued. While the moratorium on a creditor's claims is designed to facilitate a successful rescue, business rescue may be instituted solely to freeze creditors' rights. Debtors have used this moratorium solely to outmanoeuvre these obligations.

Suspending liquidation proceedings

A court application to begin business rescue proceedings may be made even after liquidation proceedings have been commenced, and this will have the effect of suspending the liquidation proceedings until the court has refused the business rescue application, or if it is granted, until the business rescue proceedings have ended. An application for business rescue can be brought merely for the purpose of delaying or suspending existing liquidation proceedings. The court then has to stop a sale in execution because business rescue has commenced. All of the time, effort and money a creditor has put into attaching the debtor's assets, advertising and arranging the sale, comes to nothing as it is put on hold. This is what the company in Oakdene was attempting to do. Another advantage of business rescue for debtors is that the mechanism of an insolvency enquiry is not available, which means reckless or fraudulent conduct by the directors cannot be properly investigated.

Power of a business rescue practitioner

The business rescue practitioner has the power to suspend or cancel any obligation of a company for the duration of the business rescue proceedings. The consequence may be that it allows the company to extricate itself from onerous contractual provisions (including reciprocal obligations) during business rescue proceedings. Creditors may therefore find themselves in a position where

they are obliged to provide services to a company which, in turn, is not obliged to pay them. For example, the practitioner of a company that is unable to pay its rental on hired premises could elect to suspend its obligation to pay rental but remain in occupation of the premises.

The secondary goal

The courts are tackling cases where a distressed company can't trade on a solvent basis, but the disposal of assets under business rescue could achieve a better return for creditors than would liquidation. The Oakdene case highlights how the secondary goal of business rescue has been a trigger for abuse, as it is less onerous than proving the first objective, as an applicant only has to prove a "better return" to gain access into the business rescue scheme.

Other case law dealing with the abuse of business rescue

In *Swart v Beagles Run Investments 25 (Pty) Ltd and Others* 2011 5 SA 422 (GNP) the creditors opposed the application for business rescue on the grounds that the application was in itself an abuse of process and a culmination of a number of attempts to avoid and postpone payment of the respondent's debts. The court agreed.

In *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd (Registrar of Banks and another intervening)* 2012 2 SA 423 (WCC) the court held that a company cannot be rendered temporarily immune to actions by creditors to enable the directors or other stakeholders to pursue their own ends.

In *Gormley v West City Precinct Properties (Pty) Ltd (Anglo Irish Bank Corporation Ltd intervening); Anglo Irish Bank Corporation Ltd v West City Precinct Properties (Pty) Ltd* 2012 ZAWCHC 33 (WCC) the court was not prepared to give the developers any leeway without a bona fide workable restructuring plan, given that rescue proceedings could lend themselves to abuse by company insiders seeking to use these provisions to frustrate creditors' rights and to stave off liquidation for motives of their own.

In *ABSA Bank Ltd v Newcity Group (Pty) Ltd* 2012 ZAGPJHC 144 (GSJ) the court held that the business rescue application brought by the applicant should be branded as an abuse and manipulation of the business rescue procedure. The court found that it was clear from the timing of the business rescue application that its sole objective was to paralyse the liquidation application.

Combating the abuse of business rescue

The Act contains measures that are intended as remedies against the very real potential for abuse by company boards of their power to start business rescue proceedings and appoint a business rescue practitioner.

A significant protection afforded to creditors is to challenge a resolution adopted by the company's board of directors. Any affected person may apply to court to have the resolution set aside on the grounds that there is no reasonable basis to believe that the company is financially distressed, or that there is no reasonable prospect that the company will be rescued, or the company has failed to comply with the procedural requirements set out in section 129.

The abuse may therefore be intercepted by certain remedies provided in the Act as court intervention on application is always at the disposal to any stakeholder. But it is debatable whether the costly and time-consuming remedy of obtaining an order of court will prove to be a very effective weapon against abuse. Even so, making it too easy to reverse a board's decisions will undoubtedly undermine the success of the business rescue proceedings. Affected persons therefore have high hurdles to clear to set business rescue proceedings aside.

One of the most important preconditions for commencement of business rescue proceedings is that there is a reasonable prospect of rescuing the company. Courts can deduce from the grounds provided whether a company is genuinely attempting to achieve the goals of business rescue or if it has an ulterior motive. The whole business rescue application balances on the court's discretion and it is ultimately within the court's discretion to dismiss an application for business rescue when it suspects that it is illegitimate and ill-founded.

The court may set aside a business rescue resolution on any of the grounds specified in section 130(1)(a) or if, having regard to all the evidence, the court considers that it is "just and equitable" to do so.

Conclusion

The Oakdene case paints an unfortunate picture of how the business rescue scheme can be abused by opportunist debtors seeking to harness the advantages and protections of business rescue for ill-founded reasons. It is clear from the judgment that the business rescue procedure should only be commenced if it is a genuine attempt to achieve the goals of business rescue, and that pursuing business rescue to achieve a winding-up of a company to avoid the consequences of liquidation proceedings will certainly not be legitimately achieving the goals of business rescue.

The case is a very good example of how the business rescue concept can be misunderstood and abused and how it may be exploited to use as an alternative, more convenient winding-up of a company. It is also an indication that courts will avoid granting business rescue applications where the benefits of doing so are outweighed by liquidation proceedings. The Oakdene case illustrates how the court can intervene and safeguard the interests of creditors, by thoroughly discussing the requirements for business rescue and how they should be applied and dismissing the application if there's been an abuse of process.

The abuse of business rescue is reflected in the number of High Court judgments dismissing applications for business rescue, instead often granting a liquidation order. The fact that business rescue legislation is so debtor-friendly but yet has resulted in so many dismissed applications (and a lot of the time liquidations), makes the abuse of business rescue very apparent.

Our courts will continue to be on alert for overzealous decisions by the board of directors to plunge a teetering business into the perceived security of the Chapter 6 lifeboat.

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