



**THE REQUIREMENTS FOR BUSINESS RESCUE PROCEEDINGS UNDER
THE COMPANIES ACT 71 OF 2008 AS DISCUSSED IN
SWART v BEAGLES RUN INVESTMENTS 25 (PTY) LTD
(FOUR CREDITORS INTERVENING) 2011 (5) SA 422 GNP.**

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Submitted in accordance with the requirements

For the degree of

LEGUM BACCALAUREUS (LLB)

at the

UNIVERSITY OF SOUTH AFRICA

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DEPARTMENT: MERCANTILE LAW

OCTOBER 2012

DECLARATION

I declare that **THE REQUIREMENTS FOR BUSINESS RESCUE PROCEEDINGS UNDER THE COMPANIES ACT 71 OF 2008 AS DISCUSSED IN SWART v BEAGLES RUN INVESTMENTS 25 (PTY) LTD (FOUR CREDITORS INTERVENING) 2011 (5) SA 422 GNP.** is my own work on the allocated topic of research for this dissertation and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.



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ACKNOWLEDGEMENTS

Above all, I Praise My God (whose name is Jehovah according to the Bible in Exodus 6: 3), who gave me strength, wisdom and grace to complete this dissertation and reach this milestone in my life and promised to walk with me yet another mile.

“O God: hold not thy peace, and be not still, O God.
For, lo, thine enemies make a tumult:
And they that hate thee have lifted up the head.
So persecute them with thy tempest,
And make them afraid with thy storm.
Fill their faces with shame;
That they may seek thy name, O LORD
Let them be confounded and troubled forever;
Yea let them be put to shame, and perish:
That men may know that thou, whose name alone is JEHOVAH,
Art the most high over all the earth”.

Psalms 83:1-18.

I want to thank the following persons for their respective contributions to this dissertation:

- My dear wife Lorato Lucricia Tselane, for her unconditional love, support and encouragement.
- My five precious children Palesa, Iustitia, Bonadeo, Rewaone and Fidelis, for their support and understanding when their father was too busy, always working.
- My Father David Tselane and mother Delilah Tselane, for their support and encouragement, and for being with me throughout my academic life with UNISA.
- ♣ A special thank you to my supervisor Professor RG Rogers, for guidance, support and encouragement, and for allowing me to be the best that I can imagine.

SUMMARY

The Companies Act 71 of 2008 was passed by Parliament on 19 November 2008 and assented to by the President on 8 April 2009. The Act came into force on 1 May 2011 and contains the provisions regulating the new business rescue proceedings that replace judicial management, as well as providing for a compromise with creditors outside business rescue proceedings. The first ruling of the Court under the new proceedings was in *Swart v Beagles Run Investments 25 (Pty) Ltd* (four creditors intervening) 2011 (5) SA 422 GNP. The respondent, Beagles Run Investments 25 (Pty) Ltd, was financially distressed as envisaged in section 128(f) of the Companies Act in that it lacked the necessary cash flow in order to be able to pay all its debts as they became due and payable within the immediate ensuing six months. The Court refused to grant an order for business rescue proceedings. Business rescue proceedings have been provided for by legislation and are available to any business institution that qualifies to be placed under business rescue proceedings according to the Act, however the ruling in the *Swart* case seems to suggest otherwise. The effect of the ruling is that the Act may not be relied upon in a blanket fashion without due regard being had to the circumstances of each case.

The crux of the matter in this research is whether the Court has the power to order or refuse business rescue proceedings after careful consideration of the interests of all parties and whether after such careful consideration of the facts and surrounding circumstances the Court is on the right track and laying reliable precedence when it grants or refuses an applicant the protection of the rescue proceedings as contained in the Act. This research firstly analyses previous legislation, how it dealt with the rescuing of businesses in distress in the past, and proceeds to analyse the new legislation and how it differs with the old legislation on business rescue proceedings. The study further analyses whether the Courts used to intervene and assist with the correct implementation of similar legislation in the past and whether the Courts at present are on the right track when assisting with the newly promulgated legislation to avoid its abuse as an escape route by debtors to avoid being held liable for reckless and bad business management to the detriment of creditors.

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1. INTRODUCTION

South African company law has made provision for a formal corporate business rescue procedure in the form of judicial management as long ago as since the inception of the Companies Act 46 of 1926.¹ Before the promulgation of the new Companies Act 71 of 2008,² which replaced the now repealed Companies Act 61 of 1973,³ businesses which were failing were either liquidated or rescued from liquidation by placing them under judicial management⁴ or Compromise.⁵

The new Act introduced two newly-created corporate rescue procedures in the form of business rescue proceedings as provided in the preamble, as well as in section 128 (b) in Chapter 6 of the Act, which facilitate the rehabilitation of a company that is financially distressed,⁶ and the compromise with creditors. Business rescue process has been a subject of interesting litigation since the case of *Swart v Beagles Run Investments 25 (Pty) Ltd* (four creditors intervening).⁷ This case demonstrated how business rescue can be abused and how the Court can intervene and safeguard the interests of creditors, and set good precedence by categorically discussing the requirements for business rescue as laid down in the new Companies Act and how such requirements should be applied.

2. STATEMENT OF THE PROBLEM

The requirements for business rescue as provided for in the new Companies Act are a convenient process which can be undertaken by a company which is financially distressed, where there appears to be a reasonable prospect of rescuing the company. During business rescue, the company's management will be under supervision and a moratorium on the rights of claimants against the company will operate⁸ The procedure is however open to abuse, for instance, by rendering the company temporarily immune to actions by creditors so as to enable the directors or other stakeholders to pursue their own ends. The thorny question arises as to what measures are open to creditors to counter such abuse. The Court dealt with this question in the *Swart* case and now the question is whether the Court has succeeded in laying precedence which may be relied upon in future and which will restore

¹ Loubser 2010 *LLD Thesis* Unisa 2

² Hereafter referred to as the new Companies Act, the Act or Act 71 of 2008

³ Hereafter referred to as the old Act or Act 61 of 1973

⁴ Section 427 of the old Act

⁵ Section 331 of the old Act

⁶ Section 129 (1) (a) of Act 71 of 2008

⁷ 2011 (5) SA 422 GNP (hereafter referred to as *Swart*)

⁸ Bradstreet 2010 *SA Merc LJ* 195.

creditors" confidence in doing business with companies, or if the ruling still lacks further qualification.

3. WHAT BUSINESS RESCUE ENTAILS

Businesses sometimes, and for unforeseen circumstances, may not do well in the corporate world. There are various factors that may give rise to the failure of a company, for example factors within the sphere where the company operates, national or international demand for a particular product, poor marketing strategies, or poor management of the company by its office bearers.⁹ Failing companies would normally be wound up and creditors paid off, with the resultant job losses for the employees of the business and bad economic impact, or attempts may be made to rescue the business. Failing businesses which have a potential to survive could be rescued in different ways, *inter alia* placing the business under judicial management; placing the company in rescue proceedings; and reaching compromises with creditors.

4. BUSINESS RESCUE IN THE OLD ACT

In terms of the old Companies Act , a company experiencing difficulty to pay its debts, but which did not want to be liquidated, had basically only two alternative options that could be regarded as "corporate rescue" procedures. Those were judicial management¹⁰ and compromises.¹¹

4.1 JUDICIAL MANAGEMENT

When any company, because of mismanagement or for any other cause was unable to pay its debts or was probably unable to meet its obligations; and had not become or was prevented from becoming a successful concern, and there was a reasonable probability that, if it is placed under judicial management, it will be enabled to pay its debts or to meet its obligations and become a successful concern, the Court would, if it appeared just and equitable, grant a judicial management order in respect of that company.

Such judicial management process was provided for in the old Act¹² but was rarely used. The main reason for its disuse was the high threshold of proof required ("reasonable probability" and not merely a possibility)¹³ for an order and the requirement that creditors" claims were to

⁹ Davis *et al Companies and other Business Structures in South Africa* 163

¹⁰ Section 427 of Act 61 of 1973

¹¹ Section 311 of Act 61 of 1973

¹² Section 427 of Act 61 of 1973

¹³ Burdette 1999 *De Jure* 58.

be paid “in full”. Judicial management has been termed “an abject failure”.¹⁴ It does not trigger a *concursum creditorum* (Commencement of winding-up by Court) as in the case of liquidation.¹⁵ In his judgment in *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd*¹⁶ Josman J referred to judicial management as “a system which has barely worked since its initiation in 1926”.

4.2 COMPROMISES

Where any compromise or arrangement was proposed between a company and its creditors the Court would, on the application of the company or any creditor or member of the company or liquidator, or the judicial manager, as the case may be, order a meeting of the creditors, or members of the company to be summoned in such manner as the Court may direct. If the compromise or arrangement was agreed to by a majority of creditors, such compromise or arrangement would, if sanctioned by the Court, bind the creditors and the company or the liquidator if the company was being wound up or the judicial manager if the company was subject to a judicial management order.¹⁷

Although compromises were regarded as a simple and relatively speedy remedy, the remedy had a major drawback in that it provided no stay of past and future legal proceedings. Litigants had to overcome this *lacuna* by applying for either provisional liquidation or provisional judicial management. Hence the attempt to save the company became expensive and self defeating.¹⁸

5. BUSINESS RESCUE IN THE NEW ACT

5.1 BUSINESS RESCUE PROCEEDINGS

Business rescue proceedings as envisaged in the new Act are proceedings which facilitate the rehabilitation of a company that is financially distressed.¹⁹ A company is deemed to be financially distressed if it appears to be reasonably unlikely that the company will be able to pay all of its debts as they fall due and payable within the immediately ensuing six months; or if it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months.²⁰ These proceedings are contained in the preamble to the Act and are provided for in Chapter 6 of the Act, which refers to business rescue and

¹⁴ Stein *The new Companies Act Unlocked* 409

¹⁵ Claasen J in *Oakdene infra* n 42 at 6

¹⁶ 2001 (2) SA 727 (CPD)

¹⁷ Section 311 of Act 61 of 1973

¹⁸ Claasen J *Supra* n 15

¹⁹ Section 129 (1) (a) of the Act

²⁰ Section 128 (f) (i)-(ii) of the Act

compromise with creditors. Business rescue proceedings may be commenced either through a resolution by the board of directors of the company or by a Court order. Business rescue facilitates the rehabilitation of a financially distressed company by providing for the temporary supervision of the company, and of the management of its affairs, business and property; provision for a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and provision for the development and implementation, if approved, of a plan (known as a business rescue plan) to rescue the company by restructuring its affairs, business, property, debt and other liabilities, as well as equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, to results in a better return for the company' s creditors or shareholders than would result from the immediate liquidation of the company.²¹

5.2 COMPROMISES

Compromise is provided for in the new Act²² and applies to a company, irrespective of whether or not it is financially distressed as defined in section 128(1)(f), unless it is engaged in business rescue proceedings in terms of the Act. The board of a company, or the liquidator of such a company if it is being wound up, may propose an arrangement or a compromise by delivering a copy of the proposal, and notice of meeting to consider the proposal, to every creditor of the company, or every member of the relevant class of creditors whose name or address is known to, or can reasonably be obtained by, the company; and the Commission. A proposal contemplated in subsection (2) must contain all information reasonably required to facilitate creditors deciding whether or not to accept or reject the proposal.

6. ADVANTAGES AND DISADVANTAGES OF BUSINESS RESCUE PROCEEDINGS

6.1 ADVANTAGES OF BUSINESS RESCUE PROCEEDINGS

Modern “corporate rescue” and reorganisation seeks to take advantage of the reality that in many cases an enterprise not only has substantial value as a going concern, but its going concern value exceeds its liquidation value.²³ The three advantages of business rescue that are cited most often are that creditors get a better return on their claims than in immediate liquidation; business rescue saves jobs; and that Business rescue does not carry the same stigma as straightforward liquidation.²⁴ The new mechanism is concerned not only with

²¹ Section 128(1)(b) of the Act

²² Section 155(1) of the Act

²³ Smits 1999 *De Jure* 107.

²⁴ Loubser 2011 *Inaugural Speech* 13.

repaying creditors, but also with protecting all affected parties by appointing a business rescue practitioner to ensure that the various interests at stake are equitably balanced within the constraints of the legislation.²⁵ Chapter 6 of the Act affords the debtor company various procedural and substantive protections during the course of the rescue proceedings, which must be carried out in terms of a 'business rescue plan' (developed and approved by the specified procedures) in terms of the company continuing in existence on a solvent basis or where this is impossible, achieving a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.²⁶

6.2 *DISADVANTAGES OF BUSINESS RESCUE PROCEEDINGS*

Business rescue procedure is open to abuse because a debtor might avoid paying creditors based on the reason of having placed the company under rescue proceedings. This might leave creditors helpless and the question arises as to what measures are available to creditors to counter such abuse. The provisions of the Act, in stark contrast with the 'creditor-friendly' focus of the preceding legislation, aim more specifically at the rescue of a business, and therefore appears to be more favourable to debtors than creditors. This shift in emphasis from a primarily creditor-friendly dispensation is likely to affect the interests of various parties in different ways, giving rise to new issues for Courts to confront.

7. **HOW BUSINESS RESCUE PROCEEDINGS CAN BE ABUSED**

If proceedings are approved, a creditor is not entitled to enforce any debt owed by the company immediately before the beginning of the business rescue process, except to the extent provided for in the business rescue plan.²⁷ A malicious debtor may apply for the proceedings while perfectly aware that it is not possible for the company to succeed and yield a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company. 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, but making it too easy to reverse a board's decisions will undoubtedly undermine the success of the business rescue proceedings.²⁸

8. **THE REQUIREMENTS OF BUSINESS RESCUE PROCEEDINGS AS DISCUSSED IN THE SWART CASE**

²⁵ Bradstreet 2011 SALJ 355.

²⁶ Section 128(1) (b) (iii) of the Act

²⁷ Section 154 (1)-(2) of the Act

²⁸ Loubser 2010 TSAR 505.

8.1 INTRODUCTION

The first ruling of the Court under the new proceedings in the new Act was in the *Swart*²⁹ case. There were no precedents to rely on and the application was the first of its kind to be brought to Court for consideration as contemplated in the Act.³⁰ The Court set out to deal with the first ever litigation on business rescue proceedings under the new Act and went on to categorically state the requirements of the Act on business rescue proceedings and to lay precedence for future reliance by other Courts on the same rescue proceedings in the Act.

8.2 THE MERITS OF THE SWART CASE

In a nutshell the merits of the *Swart* case were that the respondent, Beagles Run Investments 25 (Pty) Ltd was financially distressed as envisaged in section 128(f) of the Act. The applicant, Riaan Anton Swart, submitted that it would be beneficial for the company to be placed under business rescue proceedings as this will enable all the creditors of respondent to be fully paid in due course and respondent would be granted the opportunity to proceed with its business. The second and third intervening creditors³¹ opposed the application on the grounds that the application for business rescue 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 and that the applicant demonstrated in the application a complete negation of the rights of creditors and had carried on the business of the respondent company recklessly under admittedly insolvent circumstances.

8.3 THE REQUIREMENTS AS DISCUSSED IN THE SWART CASE

In dealing with this case the Court categorically set out the requirements of business rescue proceedings as contained in the new Act as follows:

8.3.1 Definition of business rescue

The Court defined "business rescue" in Section 128(l)(b) as proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for the temporary supervision of the company, and of the management of its affairs, business and property; a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities,

²⁹ *Ibid* n 7

³⁰ Section 130 (1) (a) of the Act

³¹ Bridging Advances (Pty) Ltd and Bideasy Auctions CC respectively

and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.

8.3.2 The procedure prescribed by Chapter 6 of the Act

In dealing with the prescribed procedure the Court contended that the procedure prescribed by Chapter 6 of the Act are to some extent similar to liquidation procedure, with the important distinction that the aim is to protect the company in that it will continue to exist on a solvent basis, after payment of creditors. In this regard the appointment of a practitioner is similar to the appointment of a liquidator and the participation of creditors and affected persons at a meeting of creditors are similar to the rights accruing to creditors in the event of liquidation.³²

8.3.3 The purpose of Chapter 6 of the Act with regard to business rescue

The Court defined the purpose of Chapter 6 of the Act with regard to business rescue as being to assist a financially distressed company by means of a business rescue plan as contemplated in section 150 of the Act, in order to maximise the possibility of the company continuing on a solvent basis, or to achieve a better return for the company's creditors or shareholders in comparison to a liquidation.³³

8.3.4 The requirements for the granting of an order sought by the applicant

The Court dealt with the requirements for the granting of an order sought by the applicant as contained in section 131(4) (a) (i) to (iii). The Court held that they were that the company is financially distressed; that with respect to employment-related matters the company failed to pay any amount; or that it is otherwise just and equitable to do so for financial reasons, and there are reasonable prospect of rescuing the company. In the event of the requirements as set out and summarised above being met, the Court held that it should exercise its discretion in favour of granting the order sought.

8.3.5 Provisions of section 131 of the Companies Act 71 of 2008

The Court held further that unless a company had adopted a resolution contemplated in section 129, an affected person may apply to a Court at any time for an order placing the company under supervision and commencing business rescue proceedings. After

³² Makgoba J in re *Swart supra* at 19

³³ Makgoba J *supra* at 18

considering an application in terms of subsection (1) the Court may make an order placing the company under supervision and commencing business rescue proceedings if the Court is satisfied that the company is either financially distressed; has failed to pay over any amount in terms of an obligation under or in terms of a public regulation, or contract, with respect to employment-related matters; or it is otherwise just and equitable to do so for financial reasons and there is a reasonable prospect for rescuing the company. If this is not the case the Court may dismiss the application and instead make any further necessary and appropriate order, including an order placing the company under liquidation.³⁴

8.3.6 Business rescue plan

The Court reiterated that It is clear that the purpose of Chapter 6 of the Act with regard to business rescue is to assist a financially distressed company by means of a business rescue plan as contemplated in section 150 of the Act, in order to maximise the possibility of the company continuing on a solvent basis, or to achieve a better return for the company's creditors or shareholders in comparison to a liquidation.³⁵ The learned Judge held the view that section 427 of the now repealed Companies Act 61 of 1973 could be of assistance in this regard, and held that essentially, in relation to section 427(1) of the old Act, what must be reasonably probable is that the company is viable and capable of ultimate solvency and that it will, within a reasonable time become a successful concern.³⁶

8.3.7 Appointment of a business rescue practitioner

The view that If the Court makes an order in terms of subsection (4) (a), the Court may make a further order appointing as interim practitioner a person who satisfies the requirements of section 138 and who has been nominated by the affected person who applied in terms of subsection (l) subject to ratification by the holders of a majority of the independent creditors' voting interests at the first meeting of creditors, as contemplated in section 147, was expressed by the Court, further explaining the circumstances in which a company may be placed under judicial management.

9. COMPARISON AND DISCUSSION OF OTHER CASES ON THE SAME SUBJECT

The Court in the *Swart* case dealt categorically with business rescue proceedings as provided for in the Act. Since the *Swart* case there has been a number of cases dealing with

³⁴ Makgoba J *supra* at 15

³⁵ Makgoba J *supra* at 14

³⁶ Makgoba J *supra* at 16

the same subject where the precedence in the *Swart* case was followed. In *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd and Others*³⁷ the Court granted business rescue application and held that it had the power to award costs to applicants for business rescue. The Court held further that the legislature did not contemplate that an affected party would have to apply for leave to intervene in the proceedings. If the person is an "affected person" such person has a right to participate in the hearing.

In *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd (Registrar of Banks and another intervening)*³⁸ the Court intensely dealt academically with business rescue proceedings as in the *Oakdene*³⁹ case and dismissed business rescue application and held that application should only be granted if concrete and objectively ascertainable details are given going beyond mere speculation.

This approach was followed in *Koen and Another v Wedgewood Village Golf & Country Estate (Pty) Ltd and Others*⁴⁰ where the Court held that *cogent* evidential foundation was required to support existence of a reasonable prospect of rescue. Binns-Ward J, agreeing with the remarks of Eloff AJ in *Southern Palace*,⁴¹ contended that at least some concrete and objectively ascertainable details should be given going beyond mere speculation in the case of a trading or prospective trading company. These pertained to the likely costs of rendering the company able to commence with its intended business, or to resume the conduct of its core business; the likely availability of the necessary cash resource in order to enable the ailing company to meet its day-to-day expenditure, once its trading operations commence or are resumed; the availability of any other necessary resource, such as raw materials and human capital; and the reasons why it is suggested that the proposed business rescue will have a reasonable prospect of success.

In *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd, Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd*⁴² the Court dismissed the business rescue application with costs and granted a final liquidation order. In this case Claasen J set out to follow the precedence in the *Swart*⁴³ case, discussing business rescue proceedings intensely and delivering judgement which is by far beautifully structured and academically enriching on the subject of business rescue proceedings. In A G

³⁷ 2011 (5) SA 600 (WCC)

³⁸ 2012 (2) SA 423 (WCC)

³⁹ 49 *Supra*

⁴⁰ 2012 (2) SA 378 (WCC)

⁴¹ 51 *Supra*

⁴² 2012 (3) SA 273 (GSJ)

⁴³ *Ibid* n 7 above

*Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd and Others*⁴⁴ the Court stressed the importance of the evidence to show that there is a reasonable prospect of the company's recovery and its continuation in business.

In *Engen Petroleum Ltd v Multi Waste (Pty) Ltd and Others*⁴⁵ the Court discussed the prescribed notification procedure; In *Gormley v West City Precinct Properties (Pty) Ltd and another*⁴⁶ the Court considered the requirements of business rescue proceedings and discussed the meaning of "financially distressed" as contemplated in the Act, and held that the sole purpose of obtaining a moratorium by means of business rescue (as was alleged to have been done by Anton Swart in the *Swart* case) will be an abuse of business rescue proceedings.

10. CONCLUSION

According to statistic South Africa, it seems that business rescue is having a significant influence on liquidations and, although this may be because the new procedure is proving to be effective (by March 2012 a total of 471 companies had made use of the procedure and 18 businesses had been successfully rescued with the help of the new legislation), the statistics may also reflect a willingness to make use the procedure as a step prior to liquidation.⁴⁷ All credit goes to our Courts in dealing with business rescue proceedings in the new Act.

The intervention of the Courts when businesses unjustifiably use business rescue proceedings as contemplated in the Act to the detriment of creditors is a good move which will provide creditors with confidence in knowing that their interests are safeguarded against reckless business management. It is an indication that the business rescue proceedings provided in the Act will not be abused as an escape route by debtors to avoid being held liable for reckless and bad business management to the detriment of creditors. This serves as good precedence which has since been relied upon, followed and improved on to deal with similar situations as those in the *Swart* case. Although the *Swart* case categorically dealt with business rescue proceedings, the Court followed a conservative approach to the process,⁴⁸ which was not dealt with more thoroughly and in logical sequence as was done in later cases dealing with the same subject.⁴⁹ The precedence laid, however, was excellent.

⁴⁴ 2012 (5) SA 515 (GSJ)

⁴⁵ 2012 (5) SA 596 (GSJ)

⁴⁶ [2012] ZAWCHC 33

⁴⁷ Bradstreet 2012 *De Rebus* 521.

⁴⁸ Joubert 2011 *De Jure* 446.

⁴⁹ *Oakdene and Southern Palace supra*

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