Business rescue proceedings as set out in Southern Palace Investments 265 Pty Ltd vs Midnight Storm Investments 386 Pty Ltd 2012 2 SA 423 − Whose interests are really protected?

Introduction

The newly introduced concept of business rescue (in terms of the Companies Act of 2008) has inspired a lot of discussion in the last few months. Cases attracting attention include 1time Airline, Top TV and the lesser-known matter of the Newcity Group, where liquidation proceedings have commenced, as business rescue was refused. These examples, along with a string of other high-profile liquidation proceedings making the news recently, prove − if nothing else − that the business rescue concept is widely misunderstood and consequently abused.

The fundamental principle of business rescue proceedings, as Keith Braatvedt adequately put it in Without Prejudice (November 2012), is as follows:

"The courts have, unless a proper and motivated business rescue plan is pleaded which demonstrates a reasonable prospect for rescuing the company, consistently dismissed the business rescue application and liquidated the company…. A close scrutiny of the actual rescue platform presented and the rationale mounted on that platform was required in order for the court to determine whether the proper threshold had been met; namely whether the is a reasonable prospect of achieving a rescue through the statutory objectives."

Therefore, it is common cause that, broadly speaking (among other requirements to be met), when making an application for business rescue, a plan setting out the reasonable prospects of rescuing the distressed company should be submitted. Any application for business rescue brought for the sole intention of delaying imminent liquidation proceedings will, therefore, fail − especially where there is no reasonable prospect of rescuing the company but the plan does not disclose this.

The case of Newcity Group Pty Ltd

This was clearly illustrated in the application for the final winding up of Newcity Group Pty Ltd, an unreported case also cited by Braatvedt (see above). In this matter, an application was brought for the final winding up of the company. Subsequently and concurrently, a shareholder brought an application for business rescue pursuant to the provisions of Section 131 of the Act. This case was particularly conspicuous because the judge noted that the application brought by the shareholder constituted an 'abuse' of the provisions and consequently the business rescue application failed.

When inspecting the business rescue plan proposed by the shareholder, the judge noted that it was common cause that the company was unable to pay all its debts yet the value of its assets

exceeded its liabilities. However, the essence of the business rescue plan was to realise the assets to pay its liabilities and/or service its debts. When considering all the facts of the case, including the shareholder's record of failing to disclose all the relevant facts, it was found that the business rescue plan was not genuine. Consequently, as stated, the application failed.

From this point, it is important to note that not only should a business rescue plan prove the distressed company can actually be rescued, but the best interests of its creditors should also be considered alongside the plan's veracity.

The case of Southern Palace Investments 265 Pty Ltd

The importance of seriously considering the interests of creditors as well as all other stakeholders is emphasised in the Act, specifically in Section 7 (k). This states that one of the purposes of the Act is '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'.*

In this case (the judge in the Newcity Group case referred to this), the Court's further aim is to make the purpose and extent of business rescue proceedings very clear in that it states: "*Business rescue does, however, not necessarily entail a complete recovery of the company in the sense that, after the procedure, the company will have regained its solvency, its business will have been restored and its creditors paid*[1]*. There is also the further recognition that even though the company may not continue in existence, better returns may be gained by adopting the rescue procedure.*[2]*"*

Furthermore, the court still has discretion over whether or not to grant the application, which is to be exercised with due consideration to the specific circumstances of each case.

The Court explained the concept and the guidelines for granting business rescue as follows:

"Every case must be considered on its own merits. It is difficult to conceive of a rescue plan in a given case that will have a reasonable prospect of success of the company concerned continuing on a solvent basis unless it addresses the cause of the demise or failure of the company's business, and offers a remedy therefor that has a reasonable prospect of being sustainable. A business plan which is unlikely to achieve anything more than to prolong the agony, i.e. by substituting one debt for another without there being light at the end of a not too lengthy tunnel, is unlikely to suffice. One would expect, at least, to be given some concrete and objectively ascertainable details going beyond mere speculation in the case of a trading or prospective trading company, of:

1 Cassim *et al* Contemporary Company Law, 2011, p783

2 See section 12S (1)(b){iii) of the new Act

24.1. the likely costs of rendering the company able to commence with its intended business, or to resume the conduct of its core business;

24.2. 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. If the company will be reliant on loan capital or other facilities, one would expect to be given some concrete indication of the extent thereof and the basis or terms upon which it will be available;

24.3. the availability of any other necessary resource, such as raw materials and human capital;

24.4. the reasons why it is suggested that the proposed business plan will have a reasonable prospect of success."

Conclusion

Although the objectives of the Companies Act are clear, and although writers such as Braatvedt have also noted that the age of creditor supremacy is over, business rescue should not be applied as a delaying tactic for the inevitable. Rather, it should be applied by financially distressed companies that are genuinely able to make a tangible and positive difference to all stakeholders through business rescue. In other words: to serve the best interests of all stakeholders as a collective must be served.

It would most certainly seem that our Courts are not inclined to grant these applications lightly. In this sense, perhaps the concept of business rescue is not too far from its predecessor, judicial management after all.

Further clarification by our courts and possibly the legislature should clearly address this in time.

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