THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Case No.: 577/2013

In the matter between:

NEWCITY GROUP (PTY) LIMITED **APPELLANT**

and

ALLAN DAVID PELLOW N.O. **FIRST RESPONDENT**
GONASGREE GOVENDER N.O. **SECOND RESPONDENT**
LEBOGANG MICHAEL MOLOTO N.O. **THIRD RESPONDENT**
LEBOGANG MORAKE N.O. **FOURTH RESPONDENT**
CHINA CONSTRUCTION BANK CORPORATION (JOHANNESBURG BRANCH) **FIFTH RESPONDENT**
ABSA BANK LIMITED **SIXTH RESPONDENT**
HENRY MAYO N.O. **SEVENTH RESPONDENT**
REZIDOR HOTEL GROUP SOUTH AFRICA (PTY) LIMITED **FIRST AFFECTED PARTY**
NON-UNIONISED EMPLOYEES **SECOND AFFECTED PARTY**

Neutral citation: *Newcity Group v Allan David Pellow NO* (577/2013) [2014] ZASCA 162 (1 October 2014)

Coram: Maya, Cachalia, Willis, Zondi JJA and Gorven AJA

Heard: **26 August 2014**

Delivered: **1 October 2014**

Summary: Companies Act 71 of 2008 – business rescue proceedings – whether company has a reasonable prospect of rescue as contemplated in s 131(4)*(a)* of the Act.

ORDER

On appeal from: South Gauteng High Court, Johannesburg (Van Eeden AJ sitting as a court of first instance)

The appeal is dismissed with costs, including the costs of two counsel where employed.

JUDGMENT

Maya JA: (Cachalia, Willis, Zondi JJA and Gorven AJA concurring)

[1] This is an appeal against the judgment of the South Gauteng High Court, Johannesburg (Van Eeden AJ). The high court dismissed the appellant's application to place Crystal Lagoon Investments 53 (Pty) Limited (in provisional liquidation), (Crystal Lagoon), under supervision and business rescue in terms of s 131 of the Companies Act 71 of 2008 (the Act)[1] and granted an order placing it under final liquidation. The appeal is with its leave.

[1] Section 128(1)(*b*) of the Act defines 'business rescue' as the proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for–

(i) the temporary supervision of the company, and of the management of its affairs, business and property;

(ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and

(iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, 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.'

[2] The appellant, Newcity Group (Pty) Limited (Newcity), is the sole shareholder of Crystal Lagoon. Mr Chaim Cohen, who deposed to Newcity's affidavits in the application, is its sole shareholder and director. Crystal Lagoon is the owner of a mid-market 273 room hotel and conference facility trading as 'Park Inn by Radisson' (the hotel). The hotel is operated by the Rezidor Hotel Group (Rezidor) in terms of a written management agreement (the management agreement) concluded between Crystal Lagoon and Rezidor.

[3] On 9 September 2009 the fifth respondent, China Construction Bank Corporation (Johannesburg Branch) (CCBC), and Crystal Lagoon concluded a property development loan facility agreement (the facility agreement). In terms of this agreement CCBC advanced a sum of R200 million to Crystal Lagoon for the purposes of building and developing the hotel. One of the material terms of the facility agreement was that on completion of the development, the facility would be converted into a ten year term loan on the basis that Crystal Lagoon would pay the interest capitalised monthly during the first year after the hotel opened so that the balance on the facility would not exceed the amount of R200 million. Thereafter, interest and capital would be repaid over the next 120 months on an amortised basis. As security for the loan CCBC took various securities, including a first deed of suretyship from Cohen, limited to an amount of R200 million, and a first mortgage bond registered over the hotel in the capital sum of R200 million.

[4] Between January 2010 and April 2011, Crystal Lagoon drew down on the loan facility. On 29 June 2010 the hotel was opened and on 29 November 2010 the development was completed. But trouble soon arose. As at 1 April 2011 the balance on the facility exceeded the sum of R200

million – the precise amount is in dispute – and Crystal Lagoon failed to pay the monthly interest on the due date and reduce the facility despite CCBC's repeated demands. It was therefore in breach of the facility agreement.

[5] On 27 January 2012 Cohen passed resolutions in terms of s 129 of the Act[2] to (a) voluntarily place the latter under supervision and commence business rescue proceedings and (b) have Mr Cornelius Fourie Myburgh appointed as its business rescue practitioner. On 3 February 2012, CCBC withdrew the loan facility and demanded immediate repayment of all the amounts due in the sum of R 215 973 902,23 together with interest thereon at the rate of 12 per cent per annum.

[6] On 22 February 2012, Myburgh was formally appointed as Crystal Lagoon's business rescue practitioner.[3] He promptly set the process in motion and called the first meeting of affected persons[4] in terms of s

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[2] Section 129 reads in relevant part:

'(1) Subject to subsection (2)(*a*), the board of a company may resolve that the company voluntarily begin business rescue proceedings and place the company under supervision, if the board has reasonable grounds to believe that–

(a) The company is financially distressed; and

(b) There appears to be a reasonable prospect of rescuing the company.

(2) A resolution contemplated in subsection (1)–

(a) may not be adopted if liquidation proceedings have been initiated by or against the company; and

(b) has no force or effect until it has been filed.'

[3] In terms of s 128(1)(*d*) 'business rescue practitioner' means a person appointed, or two or more persons appointed jointly, in terms of [Chapter 6] to oversee a company during business rescue proceedings and 'practitioner' has a corresponding meaning;

[4] According to s 128(1)(*a*) "'affected person", in relation to a company, means –

(i) a shareholder or creditor of the company;

(ii) any registered trade union representing employees of the company; and

(iii) if any of the employees of the company are not represented by a registered trade union, each of those employees or their respective representatives'.

147(1) of the Act[5] on 29 February 2012. He was optimistic that Crystal Lagoon could be rescued. He reported that five entities, which he did not specify, had expressed an interest in investing in the hotel and that he expected a formal proposal from one of them in the near future. He was expected to deliver a business rescue plan by 26 March 2012 but sought an extension from Crystal Lagoon's creditors until 13 April 2012. On 12 April 2012 Myburgh informed Cohen and the creditors that he had received a written proposal from Rezidor which would allow Crystal Lagoon's creditors not to write off any portions of the amounts owed to them, ensure that the bond repayment was maintained and all the creditors paid in full. Myburgh sought a further extension to file the business rescue plan on 4 May 2012.

[7] After protracted negotiations which dragged until late November 2012, the proposed offers[6] came to naught. Notably, they were substantially less than R200 million, required CCBC to forfeit recourse to the securities furnished by Crystal Lagoon and Cohen and were payable over extended periods of time. Significant developments had occurred in the interim. CCBC had launched an application, in which Absa intervened, to set aside Cohen's resolution placing Crystal Lagoon under supervision and have it placed under final liquidation. And on 23 October 2012 the parties had taken a consent order in terms of which Crystal Lagoon's business rescue application was set aside and an order placing it under provisional winding up was granted. Interestingly, a month later

[5] The section provides: 'Within 10 business days after being appointed, the practitioner must convene, and preside over, a first meeting of creditors, at which–

(a) The practitioner–

(i) must inform the creditors whether the practitioner believes that there is a reasonable prospect of rescuing the company; and

(ii) may receive proof of claims by creditors'.

[6] Various offers from Rezidor and other entities such as Mvelaphanda Group Limited, Curatio Capital Africa (Pty) Ltd, Zephan Properties (Pty) Limited and Extrabold Hotel Management (Pty) Limited were explored during this period.

Myburgh, who was no longer Crystal Lagoon's business rescue practitioner, participated in investment negotiations with CCBC in relation to Crystal Lagoon in his capacity as a director of Orthotouch Limited, a public company.

[8] It is against this background that Newcity brought application proceedings to have Crystal Lagoon placed under supervision and business rescue in December 2012. The application was supported by 140 members of its staff in terms of s 144(3)(*b*) of the Act.[7] In his founding affidavit, Cohen alleged that he anticipated an imminent capital injection from potential investors, Rezidor, Zephan and Curatio Capital. This would enable Crystal Lagoon to discharge its indebtedness to Absa and release Newcity from its obligations to Absa under the suretyship signed by it. And Extrabold would replace Rezidor as hotel operator. In the replying affidavit mention was made, for the first time, of other entities, whose details were specified,[8] from which it was alleged Newcity had received firm 'expressions of interest'. Reference was also made to Crystal Lagoon's daily revenue reports and the monthly operational reports for the period January to December 2012 to show that there had 'been a consistent improvement in the performance of the hotel' after the institution of the application.

[9] CCBC (and Absa) opposed the application. (Three other companies, Quantum Property Group Limited, A Million Up Investment 105 (Pty) Limited and GLM Investments (Pty) Limited subsequently launched applications to be heard as affected parties in these proceedings,

[7] Section 144(3)(*b*) of the Act reads: 'During a company's business rescue process, every registered trade union representing any employees of the company, and any employee who is not so represented, is entitled to … participate in any court proceedings arising during the business rescue proceedings.'
[8] Peermont Global (Pty) Limited, Zamcamp Investments (Pty) Limited, EAH Executive Apartments and Hotels, Hospitality Property Fund Limited, Joe Holdt and Wideopen Platform (Pty) Limited.

which they opposed, accusing Cohen and Newcity of unlawful conduct and fraud.) It contended that it would not be just and equitable to place Crystal Lagoon under business rescue as there was no reasonable prospect of rescuing it. It also contended that in the entire period of two years Newcity had failed to proffer a feasible business plan which would give Crystal Lagoon reasonable prospects of being rescued and continuing trading on a solvent basis. It pointed out that although Newcity alleged that during the time in which Crystal Lagoon was under business rescue it was able to meet all its operational expenditure. It was, however, undisputed that Crystal Lagoon was unable to pay the interest on CCBC's loan facility which formed part of its day-to-day expenses. CCBC further stated that it would not vote in favour of the proposed business plan[9] even if the business rescue application succeeded as to do so would result in increasing Crystal Lagoon's indebtedness which had already ballooned to over R230 million without a single payment either towards the interest (in the monthly sum of approximately R2,35 million) or capital since December 2011. CCBC also objected to the appointment of Myburgh whose impartiality and integrity it questioned after his involvement in the quest for the hotel. It alleged that Myburgh failed to perform certain material duties in that capacity, showed a lack of independence and had a conflict of interest. It then sought an order placing Crystal Lagoon under final winding up, in the event that the

[9] Section 145(2) gives creditors, inter alia:
'*(a)* the right to vote to amend, approve or reject a proposed business rescue plan, in the manner contemplated in section 152; and
(b) if the proposed business rescue plan is rejected, a further right to-
(i) propose the development of an alternative plan, in the manner contemplated in section 153; or
(ii) present an offer to acquire the interests of any or all of the other creditors in the manner contemplated in section 153.'

business rescue application was unsuccessful, which the court below granted.

[10] The court below accepted that Crystal Lagoon was financially distressed. Regarding whether there was a reasonable prospect for its rescue as envisaged in s 129 of the Act, the court found that it was unnecessary for a business rescue applicant to attach a business rescue plan to its founding affidavit. In the court's view it merely had to 'advance facts that could be developed into a plan that, if approved, would maximise the likelihood of the company continuing in existence on a solvent basis or … result in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company' as contemplated in s 128(1)(*b*) of the Act. The court further held that if there was a reasonable possibility of the occurrence of either of these two events the jurisdictional requirements would have been satisfied for a court to exercise its discretion to grant the relief sought. The court below thus held that on the facts before it neither the proposed replacement of Rezidor with a different manager, which would likely result in litigation, nor the touted third party funding offers, of which none had proven viable in over a year, created a reasonable prospect that rescue the company would be rescued. 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 a grant of a final winding up order.

[11] It is common cause that Newcity and CCBC are both affected persons as envisaged in s 128(*a*)(*i*) of the Act. And it is not in dispute that Crystal Lagoon is financially distressed within the contemplation of s 131(4)(*a*)(*i*) as it is commercially and factually insolvent: it is unable to

pay CCBC's debt, which is due and payable, and its liabilities exceed its assets. (There was some contestation between the parties regarding the computation of the value of Crystal Lagoon's assets but it falls short of its liabilities on any version.) The main issue on appeal before us, therefore, is simply whether Newcity has shown a reasonable prospect of rescuing Crystal Lagoon.

[12] It was argued on Newcity's behalf that (a) the facility agreement contemplated a repayment period in excess of ten years thereby allowing Crystal Lagoon to accumulate capital through the conduct of the business in order to repay the loan; (b) CCBC impermissibly withdrew the loan facility as it did so not on the basis of non-payment but rather as a result of the company having exceeded the facility, which specifically contemplated an increase in excess of R200 million against which the interest payable would be increased; (c) it had demonstrated that there was a reasonable prospect for rescuing the company which, on the undisputed version of the hotel operator Rezidor, was improving and making profit notwithstanding that it was in the challenging start-up phase, the so-called 'ramp-up phase' which lasts about four years, during which a newly opened hotel attempts to penetrate the market and establish its fair market share against its competitors; (d) Crystal Lagoon had received binding expressions of interest from third parties keen to invest capital in the hotel which would facilitate a repayment of the debt to CCBC and (e) liquidating Crystal Lagoon, which would cost far more than business rescue, would destroy the business and its 140 employees' jobs. Newcity also challenged Absa's standing in the appeal on the basis that Crystal Lagoon's indebtedness to it was disputed and the subject of pending proceedings in the high court. But nothing turns on this.

[13] CCBC's case, on the other hand, was that the appeal should fail simply by reason of Newcity's failure to establish in its papers that there was a reasonable prospect to rescue Crystal Lagoon. This court consequently had no cause to exercise its discretion, continued the argument, and even if it did the appeal must nevertheless fail if proper regard was had to the competing interests of the creditors, shareholders, employees and the public interest.

[14] Section 131of the Act provides for a 'court order to begin business rescue proceedings' and reads in relevant part:

'(4) After considering an application in terms of subsection (1), the court may–

(*a*) make an order placing the company under supervision and commencing business rescue proceedings, if 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 … contract …; or

(iii) it is otherwise just and equitable to do so for financial reasons,

and there is a reasonable prospect for rescuing a company; or

(*b*) dismissing the application, together with any further necessary and appropriate order, including an order placing the company under liquidation.'

[15] 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 for rescuing the company ie facilitating 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.[10] In deciding that question the court exercises a discretion in the wide sense – it makes a value judgment – and if a court of appeal should disagree with the conclusion, it is bound to interfere.[11]

[16] As to what 'reasonable prospect' means, Brand JA, in *Oakdene Square Properties (Pty) Ltd*,[12] properly described it as a yardstick higher than 'a mere prima facie case or an arguable possibility' but lesser than a 'reasonable probability' – a prospect based on reasonable grounds to be established by a business rescue applicant in accordance with the rules of motion proceedings. He elaborated as follows:[13]

'Self-evidently it will be neither practical nor prudent to be prescriptive about the way in which the [applicant] must show a reasonable prospect in every case. Some reported decisions laid down, however, that the applicant must provide a substantial measure of detail about the proposed plan to satisfy this requirement … But in considering these decisions Van der Merwe J commented as follows in *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd and another* 2013 (1) SA 542 (FB) para 11:

"I agree that vague averments and mere speculative suggestions will not suffice in this regard. There can be no doubt 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. But with respect to my learned colleagues, I believe that they place the bar too high."

And in para 15:

"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 business, and the likely availability of the

[10] Section 128(*b*) and (*h*) of the Act.
[11] *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others* 2013 (4) SA 539 (SCA) para 21.
[12] Ibid para 29.
[13] At paras 30-31.

necessary cash resource in order to enable the company to meet its day-to-day 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."

… I agree with these comments in every respect … [Thus] the applicant is not required to set out a detailed plan … but must establish grounds for the reasonable prospect of achieving one or two goals in s 128(1)(*b*).'

[17] This leads to the crisp question whether Newcity established grounds for the reasonable prospect of restoring Crystal Lagoon to solvency or, if that was not possible, to provide a return for its creditors and shareholders better than what they would receive through liquidation.

[18] A close look at each of the 'third party offers' mentioned in Newcity's founding affidavit – in which its case ought to have been made out – readily shows that they were not commercially viable, would not have resulted in the temporary supervision envisaged in the Act[14] and were, in any event, probably no longer available. They all amounted to a mere substitution of Crystal Lagoon with another debtor over prolonged periods. As mentioned above, they required CCBC to write off substantial portions of the loan facility in excess of R70 million, provide funding and forfeit the securities put up by Crystal Lagoon to which CCBC was understandably not prepared to accede.

[14] For example, in s 128(1)(*b*)(i) and (ii) which respectively refer to 'temporary supervision of the company' and 'a temporary moratorium on the rights of claimants against the company' and s 132(3) which contemplates completion of the business rescue proceedings within three months or, upon application by the business rescue practitioner, such longer time as the court may allow.

[19] For example, the Rezidor agreement, touted as a firm agreement, was upon scrutiny merely a 'statement of the parties intentions' and subject to the conclusion of 'Formal Agreements', Rezidor's board would approve the transactions and its funders would agree to advance a sum not less than R160 million within 21 days failing which the agreement would lapse. As it turned out, none of these conditions came to fruition and the agreement failed because Rezidor itself was unwilling to confirm that it had raised the necessary funds or that its board had approved the proposed transaction. As already stated, the offers also contemplated that another entity, Extrabold, would replace Rezidor and manage the hotel, a plan which Rezidor said it would fiercely resist in light of the existing management agreement. It bears mentioning that in addition to a number of problems besetting the Extrabold offer, the projected fixed rental which would have been received from it under the 25-year lease agreement it proposed to conclude with Crystal Lagoon, which would provide a source of income to service the debt owed to CCBC, would have yielded an amount to no more than R1,3 million a month. This would not have even covered the monthly interest of about R2,35 million.

[20] The so-called 'expressions of interest' from other entities mentioned for the first time in the replying affidavit were also not capable of yielding any concrete funding. The simple fact is that Crystal Lagoon remained unable to service the debt due to CCBC or even pay its manager, Rezidor in over three years. There is no reasonable prospect of returning Crystal Lagoon to solvency in these circumstances.

[21] As to whether there is a reasonable prospect that business rescue would yield a better return for Crystal Lagoon's creditors and shareholders, all that is alleged in Newcity's affidavits is that the costs of

liquidation would exceed those incurred in business rescue. But, as was pointed out in *Oakdene Square Properties*,[15] 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'. And that apart, Newcity does not even show that such a saving would result. It was correctly contended on CCBC's behalf that Newcity's calculations in its replying affidavit overlooked the litigation costs that would be incurred in relation to the termination of the management agreement. In addition, other costs such as the interest that had already accrued in excess of R30 million, the costs to be paid in terms of the envisaged Extrabold lease agreement in excess of R10 million, attorneys' and directors' fees in addition to the business practitioner's costs and transactional fees would be incurred by Crystal Lagoon should agreements be concluded or the loan refinanced.

[22] But there is a more fundamental hurdle for Newcity to overcome. On its version, the hotel property is worth R297 million. Assuming that this is the true value of the property that will be realised on liquidation, CCBC as a secured creditor would then receive the capital sum of the R200 million and have a concurrent claim for the balance of R30 million constituted by undisputed interest. As was correctly contended for CCBC, to meet the minimum threshold to qualify as a business rescue mechanism in this scenario, any business rescue plan would have to provide a return for CCBC of at least R200 million. As indicated, none of the proposed offers came anywhere close to providing a payment to CCBC over and above of what it could expect to receive in liquidation as they involved payments substantially less than R200 million over protracted periods of time and required CCBC to forfeit the securities it

[15] Ibid, para 33.

held. This starkly 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.

[23] In the premises, Newcity has 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 (bearing in mind that CCBC is its majority creditor holding in excess of 75 per cent of its independent creditor's voting interests, envisaged in ss 128(1)(*j*) and 145(4), (5) and (6) of the Act) and sole shareholder (Newcity) than what they would receive through liquidation. As I see it, the matter ends here and the enquiry does not progress to issues regarding the exercise of this court's discretion and balancing the interests of the creditors, shareholders, employees and the public interest that was urged upon us. Suffice it to say, however, that all indications are that the liquidator would be able to sell the hotel as a going concern and thereby yield a better result for all concerned than placing it under business rescue.

[24] In the result, the appeal is dismissed with costs, including the costs of two counsel where employed.

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MML MAYA

JUDGE OF APPEAL

APPEARANCES:

For Appellant:	JJ Brett SC (D Mahon) Instructed by: Terry Mahon Attorneys, Sandton Webbers, Bloemfontein
For Fifth Respondent:	AJ Eyles (JM Hoffman) Instructed by: Bowman Gilfillan, Sandton Symington & De Kok, Bloemfontein