

02

GROUNDS FOR THE COMMENCEMENT OF BUSINESS RESCUE PROCEEDINGS


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Presented by

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Recap of Chapter 6 of the
Companies Act 71 of 2008

The Objectives of business rescue

The grounds for commencement
of business rescue

Persons who will be forewarned
of financial distress

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Recap of Chapter 6 of the Companies Act 71 of 2008

- Chapter 6 of the 2008 Companies Act fundamentally rewrites South African company law from a restructuring perspective and has far-reaching effects on the rescue of companies
- Prevents demise of viable companies
- Balance is struck between the interests of the debtor company and those of the creditors

“ EXCELLENCE IS NOT A GIFT, BUT A SKILL THAT TAKES PRACTICE.
WE DO NOT ACT 'RIGHTLY' BECAUSE WE ARE 'EXCELLENT',
IF FACT WE ACHIEVE 'EXCELLENT' BY ACTING 'RIGHTLY'. ”
- Plato



Important Definitions

- **Business Rescue** - proceedings to facilitate the rehabilitation of a company that is **financially distressed** by providing for—
 - temporary supervision of the company, and of the management of its affairs, business and property;
 - temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and
 - 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 –
 - ❖ maximizes the likelihood of the company continuing in existence on a solvent basis; or
 - ❖ results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.



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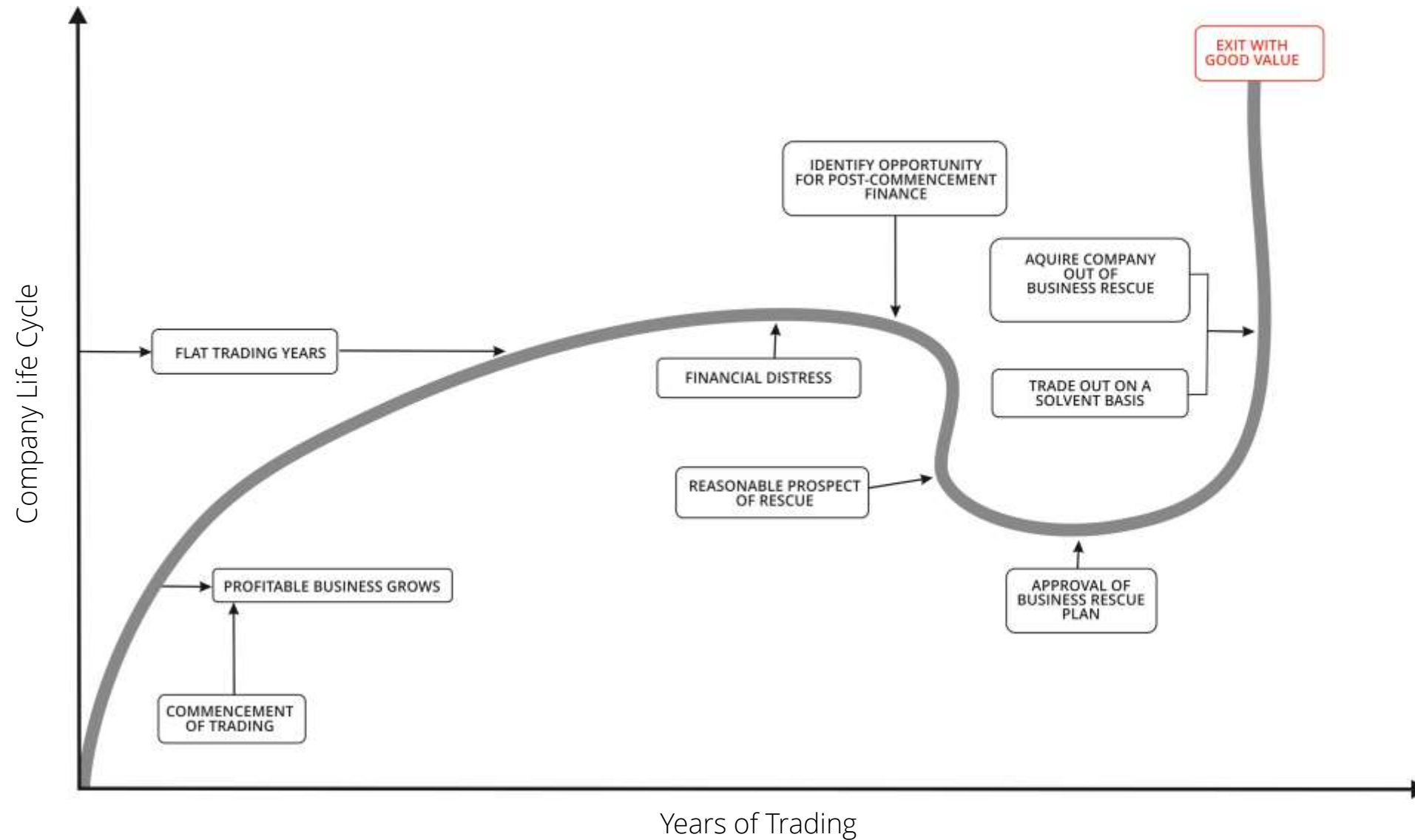
Objectives of Business Rescue

Oakdene Square Properties (Pty) Ltd and Others v Farm
Bothasfontein (Kyalami) (Pty) Ltd and Others 2013 (4) SA 539 (SCA)

- The objective of business rescue *"must be either to restore the company to a solvent going concern, or at least to facilitate a better deal for creditors and shareholders than they would secure from a liquidation process..."*
- Thus two objectives of Business Rescue
 1. maximising the likelihood of the company continuing in existence on a solvent basis; or
 2. a controlled/quasi-liquidation that results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.



Life of a Company in the Business Rescue Context



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Grounds for the commencement of business rescue proceedings

- Not all companies are suitable for business rescue
- The cause of the company's financial distress must be considered
- Most companies with debt issues will consider business rescue for the benefit of the moratorium on claims
- However, companies without a realistic hope of survival will inevitably end up in liquidation – no merit in placing a company into business rescue when liquidation can achieve the same result
- When a liquidator could achieve a distribution of the same or very similar dividends for creditors there is no need to place the company into rescue



Grounds for the commencement of business rescue proceedings

Kovacs Investments 571 (Pty) Ltd v Investec Bank Ltd and another; Investec Bank Ltd v Aslo Holdings (Pty) Ltd (25051/11, 18112/2011) [2012] ZAWCHC 110 (22 February 2012)

- A reasoned and factual basis for belief that the company can be rescued is required
- Vague and speculative averments are not sufficient

Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd 2012 (2) SA 423 (WCC)

- Applicant for business rescue must provide concrete and factual details of the course, 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



Decision to enter Business Rescue

- Difficult in small privately owned companies (especially with a history of family involvement – too emotionally attached). Need input from independent/non-executive directors to make the "right decision", devoid of personal interests and agendas (e.g. suretyships and damages claims)
- Cannot be "blind to reality"... cannot always blame financial distress on a "poor economy" – sometimes "it is just a bad business"!
- Decision to enter business rescue is usually brought about by an "aggressive creditor"... pushes company over the abyss... and where there is an urgent need for the protection of a moratorium
- Delay in the intervention of a business rescue process results in creditors carrying the risk of diminished dividends
- If the company is not a candidate for business rescue – preferable to place it into liquidation



Grounds for the Commencement of Business Rescue Proceedings

Propspec Investments v Pacific Coast Investments 97 2013 (1) SA 542

- *'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.'*
- The legislative preference for business rescue is also articulated in S7(k) 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.'



Grounds for the Commencement of Business Rescue Proceedings

Welman v Marcelle Props 193 CC & Another (2012) JOL 28714 (GSJ)

"Business rescue proceedings are not for terminally ill close corporations. Nor are they for chronically ill. They are for ailing corporations, which given time will be rescued and become solvent"

- First signs of financial distress – company must apply for business rescue
- If more than just "financially distressed" the company should consider other options such as a liquidation
- What if the company is insolvent? Is it a candidate for business rescue?



Grounds for the Commencement of Business Rescue Proceedings

Tyre Corporation Cape Town Proprietary Limited & Others v GT Logistics Proprietary Limited & Others (Rogers J) [2016] (WCC)

- "Current commercial or factual insolvency is not a prerequisite. This is understandable. But it does not follow that, because the company is already commercially or factually insolvent, and thus obviously financially distressed, it can no longer be the subject of business rescue. Such an interpretation would be inconsistent with s 5(1) read with s 7 of the Act, particularly paras 7(d) and (k), since it would oblige the court to liquidate a company even though there might be a reasonable prospect of rescuing it."
- "Even if the proposition...were correct, this would not...be a bar to business rescue since in terms of s 131(4)(a)(iii) the court can grant a business rescue order if it is just and equitable to do so for financial reasons, i.e. whether or not the company is 'financially distressed.'

Important Definitions

- **Financially Distressed** - 6 month forward looking test -
 - 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 (commercial insolvency test); or
 - it appears to be reasonably likely that the company will become “insolvent” within the immediately ensuing six months (factual/balance sheet insolvency).



Grounds for the Commencement of Business Rescue Proceedings

- Clear distinction between “insolvent” and “financial distress”
- Business rescue test –
 - forward looking test
 - Contemplates impending insolvency (commercial insolvency or factual insolvency)
 - the business rescue procedure should be started at an early stage.
- Only companies which are financially distressed should be allowed to file for business rescue



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Who will be forewarned of Financial Distress

Auditors	during the audit process, auditors may very well qualify their financial statements and bring the attention of financial distress to the attention of board members and those that rely on the financial statements (ie going concern or reportable irregularity)
South African Revenue Services	if VAT and/or PAYE are not being paid, SARS should be aware at a very early stage of the existence of financial distress
Employees	one of the first signs of financial distress will be employee salaries not being paid on time or reduced working hours as a result of ineffective cash flow
Financial Institutions	overdraft and loan facilities not being met on time (i.e. call up of a cession of debtors)
Lawyers	general counsel and law firms representing companies in financial distress will be inundated with legal process, summonses, actions and writs of execution
Creditors	creditors would be the first to know of financial distress as a result of credit terms not being met and in particular when companies are placed on a cash supply basis as opposed to normal credit terms
Judgement Creditors	once in receipt of a "nulla bona" return (i.e. insufficient disposable property to meet a judgement debt) from the sheriff, entitled to demand a set of the most recent annual financial statements of a company within 5 business days after making a demand (section 31(2) of the Act)
Trade Unions	given access to company financial statements through the CIPC (under conditions as determined by the CIPC) for purposes of initiating a business rescue process
Shareholders	lack of reporting, negligible dividends and lack of financial information being made available to shareholders would be a sure sign of financial distress

Issues to Consider

- Directors have an obligation to consider the financial state of the company
- Beware of sections 22(1), 77(3)(b), 128(1)(f) and 218(2) of the 2008 Companies Act – reckless conduct, gross negligence, conduct calculated to defraud creditors
- If company is financially distressed, the directors have two choices –
 - pass a resolution to commence business rescue; or
 - send out what is commonly referred to as a "section 129(7) notice"–
 - notify affected persons of the nature of the company's financial distress (i.e. impending commercial or balance sheet insolvency); and
 - reasons for not adopting a resolution to commence business rescue.
- Notice needs to be carefully considered



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End of Unit 02

THANK YOU

