SOUTHERN PALACE INVESTMENTS 265 (PTY) LTD v MIDNIGHT STORM INVESTMENTS 386 LTD 2012 (2) SA 423 (WCC) D

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Citation	2012 (2) SA 423 (WCC)
Case No	15155/2011
Court	Western Cape High Court, Cape Town
Judge	Eloff AJ
Heard	November 25, 2011
Judgment	November 23, 2011
Counsel	*FA Saint* for the applicant. *LS Kuschke SC* for the first intervening party. *AS de Villiers* (with *JT Benade*) for the second intervening party.
Annotations	Link to Case Annotations

E

Flynote : Sleutelwoorde

Company — Business rescue — Requirements — Reasonable prospect of rescue F — Meaning — Less required than reasonable probability of rescue — Companies Act 71 of 2008, s 131(4)(a).

Company — Business rescue — Supervision — Order of — Court's discretion to grant — Court to give due weight to legislature's preference for rescue of ailing companies — Companies Act 71 of 2008, s 131(4)(a). G

Company — Business rescue — Requirements — Reasonable prospect of rescue — Evidence — Where aim of rescue that company continue in existence — Business plan addressing cause of business' failure and offering remedy — Concrete details of: likely costs to commence or resume business; H likely cash resources for day-to-day expenditure; availability of other necessary resources; and reasons why plan had reasonable prospect of success — Companies Act 71 of 2008, ss 128(1)(b)*(iii) and 131(4)*(a).

Company — Business rescue — Requirements — Reasonable prospect of rescue — Evidence of — Where aim is better return than if immediate liquidation — Concrete details of source, nature and extent of resources likely I available, and terms on which available — Speculative suggestions insufficient — Companies Act 71 of 2008, ss 128(1)(b)*(iii) and 131(4)*(a).

Headnote : Kopnota

In issue in this application for a business rescue was the meaning of the term 'reasonable prospect' in s 131(4) of the Companies Act 71 of 2008. That section provides that: J

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A '(4) After considering an application [for a business rescue] 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 B obligation under or in terms of a public regulation, or contract, with respect to employment-related matters; or

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

and there is a reasonable prospect for rescuing the company; or
(b) dismissing the application, together with any further necessary and appropriate order, including an order placing the company under C liquidation.'
The court noted that the term 'reasonable probability' had been used in the judicial management s 427(1) of the 1973 Companies Act and that the use of different language in s 131(4) indicated that something less was required D than that the recovery should be a reasonable probability. It noted, moreover, that the mind-set reflected in various cases dealing with judicial management applications in respect of the recovery requirement was that, prima facie*,* the creditor was entitled to a liquidation order, and that only in exceptional circumstances would a judicial management order be granted. The approach to business E rescue in the new Act was the opposite — business rescue was preferred to liquidation. (Paragraph [21] at 431E – F.)
However, even if the substantive test with its lower threshold was satisfied, a court still had a discretion not to grant the order. In exercising this discretion, a court should give due weight to the legislative preference for rescuing ailing companies if such a course was reasonably possible. It would therefore be inappropriate for a court faced with a business rescue F application to maintain the mind-set (from the earlier regime) that a creditor was entitled *ex debito justitiae* to be paid or to have the company liquidated. (Paragraph [22] at 431F – H.)
The court also considered the information that an applicant should supply it with, and in particular a business plan. It noted that while every case had to G be considered on its own merits, it was difficult to conceive of a rescue plan in a given case that would have a reasonable prospect of success of the company concerned continuing on a solvent basis, unless it addressed the cause of the demise or failure of the company's business, and offered a remedy therefor that had a reasonable prospect of being sustainable. A business plan which was unlikely to achieve anything more than to H prolong the agony, ie by substituting one debt for another without there being light at the end of a not too lengthy tunnel, was unlikely to suffice. A court 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. The likely costs of rendering the company able to commence with its I intended business, or to resume the conduct of its core business;
2. the likely availability of the necessary cash resources in order to enable the ailing company to meet its day-to-day expenditure, once its trading operations commence or were resumed. If the company would be reliant on loan capital or other facilities, a court would expect to be given some concrete indication of the extent thereof and the basis or J terms upon which it would be available;

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3. the availability of any other necessary resources, such as raw materials A and human capital;
4. the reasons why it was suggested that the proposed business plan would have a reasonable prospect of success. (Paragraph [24] at 432A – E.)

In relation to the alternative aim referred to in s 128(1)*(b)*(iii) of the new Act, being to procure a better return for the company's creditors and shareholders B than would result from the immediate liquidation thereof, one would expect an applicant for business rescue to provide concrete factual details of the source, nature and extent of the resources that were likely to be available to the company, as well as the basis and terms on which such resources would be available. It was difficult to see how, without such details, a court would be able to compare the scenario sketched in the application with that which would obtain in an immediate liquidation of the company. Mere C speculative suggestions were unlikely to suffice. (Paragraph [25] at 432E – G.)

Cases Considered

Annotations:

Statutes Considered

Statutes D

The Companies Act 71 of 2008, ss 128(1)*(b)*(iii) and 131(4)*(a)*: see *Juta's Statutes of South Africa 2010/11 Supplement* vol 2 at 2-70 – 2-71.

Case Information

Application for business rescue.

FA Saint for the applicant. E

LS Kuschke SC for the first intervening party.

AS de Villiers (with *JT Benade*) for the second intervening party.

Cur adv vult.

Postea (November 25). F

Judgment

Eloff AJ:

[1] The commencement of the Companies Act 71 of 2008 (the new Act) introduced profound changes to the legislation governing companies in this country. One such change is a new remedy available to ailing G companies, being a business rescue. It constitutes a major theme of the new Act, and is amplified in s 7*(k)* thereof, which 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'.

[2] Like its Australian equivalent, [1] one of the aims of the remedy is to H render it possible for companies in financial difficulty to avoid winding-up and to be restored to commercial viability. [2] Both jurisdictions recognise the desirability of a company in distress to continue in existence. Business rescue does, however, not necessarily entail a complete recovery of the company in the sense that, after the procedure, the I company will have regained its solvency, its business will have been

A restored and its creditors paid. [3] 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. [4]

[3] The scheme created by the business rescue provisions in Ch 6 of the B new Act envisages that the company in financial distress will be afforded an essential breathing space while a business rescue plan is implemented by a business rescue practitioner. It is, however, necessary to caution against the possible abuse of the business rescue procedure, 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. C The courts in Australia have been careful not to allow their equivalent procedure to be used where there appears to be an ulterior purpose behind the appointment of an administrator by the directors. [5] It is necessary that an application for business rescue be carefully scrutinised so as to ensure that it entails a genuine attempt to achieve the aims of the statutory remedy. The instant case is one where such attempt was not D discernible from the affidavits filed of record.

[4] On 20 May 2011 Zoneska Investments (Pty) Ltd (Zoneska) launched an application for the compulsory winding-up of the respondent, Midnight Storm Investments 386 Ltd, based on its inability to pay E its debts.

[5] The amount of the indebtedness of the respondent to Zoneska was said to be R561 656,45, being the outstanding balance of moneys lent and advanced by Zoneska to the respondent in terms of a written agreement of loan. But for the application subsequently launched by F Southern Palace Investments 265 (Pty) Ltd (Southern Palace) on 27 July 2011 for business rescue proceedings to be commenced in respect of the respondent in terms of the provisions of s 131(1) of the new Act (the business rescue application), there was no reason for the winding-up application of Zoneska not to be granted. On 28 October 2011 I dismissed the business rescue application of Southern Palace with G costs and issued an order placing the respondent in provisional winding-up. My reasons for making these orders follow below.

[6] Southern Palace, represented by Mr R Hassim, relied for its locus standi to launch the business rescue application on a claim which it H acquired against the respondent from another creditor

thereof. It accordingly qualified as an 'affected person', as defined in s 128(1)*(a)*(i) of the new Act.

[7] The Registrar of Banks featured as the first intervening party in the business rescue application, and Zoneska became the second intervening

party. Each of these intervening parties delivered a detailed factual A response on affidavit to the business rescue application. Neither of them supported the application.

[8] The following facts served as background to the business rescue application:

[8.1] Midnight Storm is one of several companies in the so-called B Realcor group, most of which find themselves in (voluntary) business rescue or in provisional liquidation.

[8.2] These companies include Purple Rain Properties 15 (Pty) Ltd (Purple Rain) and Africa's Best 258 (Pty) Ltd (Africa's Best). At the instance of creditors of these two companies, I made orders on 27 October 2011 placing them in provisional winding-up. C

[8.3] Some of the companies in the Realcor group such as Midnight Storm and Africa's Best involved themselves in the acquisition and development of commercial properties. Africa's Best established a retail shopping mall in Grabouw, Western Cape, and D Midnight Storm is the owner of a property in Blaauwberg on which the construction of a luxury hotel is in an advanced stage of completion. Purple Rain conducted a construction business, and it apparently performed much of the construction work in relation to the hotel.

[8.4] The businesses of the companies were conducted under the E directorship of Ms Deonette de Ridder (De Ridder) and Mr WB Nortje (Nortje). De Ridder is also a director of various other companies in the Realcor group, including Gray Haven Riches 9 Ltd, Gray Haven Riches 11 Ltd and Iprobrite Ltd (the investment companies), to which I shall make reference below. F

[9] The business rescue application was one of three such applications, the other two relating to Africa's Best and Purple Rain. The applications relating to those two companies failed, which resulted in them being placed in provisional winding-up. In each of those cases there was no real answer to the liquidation application, and the business rescue application G was devoid of any merit. In fact, in respect of Africa's Best, counsel and the attorney acting for the applicants in the business rescue application withdrew as such, and the application was dismissed. In respect of Purple Rain, counsel who moved the business rescue application, and who also moved the business rescue application in respect of Midnight Storm, did not show any enthusiasm for the Purple Rain business H rescue application. This was unsurprising, because there was no merit in that application. It was similarly dismissed.

[10] The funding of the operations of the companies in the Realcor group, including Africa's Best, Purple Rain and Midnight Storm, occurred as follows: I

[10.1] The Realcor group, under the directorship of De Ridder and Nortje, used the investment companies to raise capital from members of the public by way of offers contained in a number of prospectuses. The particular mechanism that was used by the investment companies to raise funding was that one-year debentures, five-year debentures and various classes of shares J

A in the investment companies were issued to members of the investing public, consisting of approximately 3000 individual persons.

[10.2] In this manner, an amount in excess of R616 million was collected over a period of time from subscribing members of the public. These funds were principally used for the construction B of the hotel of Midnight Storm in Blaauwberg. Members of the public

were led to believe that they had acquired interests in the company owning the hotel itself.

[11] In 2008 the then governor of the South African Reserve Bank C appointed Ms L McPhail and two other persons as inspectors in accordance with the provisions of s 12 of the South African Reserve Bank Act 90 of 1989, to investigate the conduct of companies in the Realcor group in relation to the manner in which funds had been taken from members of the public by way of the mechanism described earlier. On 26 August 2008 the Deputy Registrar of Banks appointed D Ms McPhail and her team in terms of the provisions of s 84 of the Banks Act 94 of 1990, to act as managers in order to manage and control the repayment of such funds by the companies in the Realcor group to the investors. These appointments resulted from the fact that the mechanism employed by the Realcor group to obtain funding from members of E the public was unlawful and contravened the provisions of the Banks Act.

[12] Having conducted a thorough and detailed investigation into the affairs of various companies in the Realcor group, including Midnight Storm, Purple Rain and Africa's Best, Ms McPhail was able to provide F useful and detailed information, on behalf of the Registrar of Banks, in relation to the financial affairs and position of, inter alia, Midnight Storm. That affidavit formed part of the papers in the current business rescue application.

[13] The consequence of the actions of the Registrar of Banks, in G requiring the repayment of funds unlawfully received by companies in the Realcor group from members of the public, was that Purple Rain was unable to complete the construction of the respondent's hotel in Blaauwberg, and such construction activities came to a rapid halt. Purple Rain ceased conducting any further business.

H [14] Of importance is the fact that Purple Rain apparently acted as the banker in the Realcor group. Various funds were channelled through Purple Rain between the companies in the group. Ultimately, its accounting records were said to reflect positive balances in respect of various intercompany loans that were relied upon in its own business rescue application as constituting its major assets. However, such 'assets' I were plainly valueless, because the intercompany loans were irrecoverable. A proper set of financial statements for Purple Rain would probably have reflected a complete impairment of such suggested assets.

[15] Reverting to the current business rescue application of Southern Palace, the contents thereof were extremely terse, vague and uninformative. J What the main deponent, Mr Hassim, proposed therein was that a

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globular approach was to be adopted to the three business rescue A applications (those of Africa's Best, Purple Rain and Midnight Storm) and that regard was to be had to the fact that he himself, in his capacity as a trustee of companies to be formed, had contributed vast sums to a number of companies in the Realcor group in order to rescue them. Moreover, reliance was sought to be placed on an affidavit deposed to by B Mr DF du Toit Burger, a businessman whose family trust had invested more than R2 million in Gray Haven Riches 11 Ltd on the strength of public offers, and who had taken it upon himself to act on behalf of an 'investors' forum', which represented the interests of some 3400 investors in the investment companies. The relevant parts of what Mr Burger had to say was that: C

[15.1] The respondent, which had conducted its business under the control of De Ridder, was financially distressed.

[15.2] In view of the fact that the Realcor group of companies was interrelated in respect of shareholding, loan accounts, creditors D and suretyships, all of such companies had been involved in an attempt to construct a rescue package. The liquidation of one of such companies would, however, result in the liquidation of the respondent and ultimately also the liquidation of the investment companies.

[15.3] The globular rescue package consisted of agreements that had E been concluded with

Mr Hassim as a trustee for several companies to be formed, and the purchase consideration payable by Mr Hassim for such companies would be used to discharge the obligations of the companies in the Realcor group to their creditors. The agreements constituting the globular F rescue package were, however, subject to the fulfilment of suspensive conditions, one of which was that the written permission of the Registrar of Banks or Ms L McPhail and her team was to be obtained in terms of the provisions of s 84 of the Banks Act. Such permission was, however, not obtained. G

[15.4] Southern Palace and Mr Hassim were still committed to rescue the respondent by negotiating new agreements with 'all stakeholders' in order to discharge the obligations of the respondent's creditors, including its bondholder, to secure further funds to complete the construction of the hotel and to enter H into further agreements with the investors with a view to Southern Palace acquiring their shares in the respondent.

[15.5] If the new rescue plan was allowed to continue, all investors would benefit, the hotel would be completed and an income would be generated by the respondent through the operation thereof. I

[15.6] Were the respondent, however, to be wound up, the investors would suffer most, because, instead of procuring the opening of the hotel, the investors would be left with almost nothing.

[15.7] The business rescue plan depended on co-operation between all the entities within the Realcor group and with Mr Hassim. J

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A [16] Zoneska responded to the business rescue application by way of an affidavit deposed to by Mr Duvenage. He pointed out trenchantly that:

[16.1] The respondent was indebted to the investment companies in an amount of approximately R415 million;

[16.2] the respondent was bereft of any income and the construction work in respect of the hotel had already been suspended for B many months;

[16.3] a further amount of approximately R200 million would be required to complete the construction of the hotel and to render it ready for business;

[16.4] an amount of R52 million was owed by the respondent to its C bondholder, being First National Bank;

[16.5] there was no reason to believe that the proposed new rescue plan which Mr Hassim was about to offer would result in the respondent becoming a successful concern.

[17] As at the date of the hearing of the application for business rescue, D being 26 October 2011, no new business rescue offer or agreement from Mr Hassim or Southern Palace had come about. Mr *Saint*, counsel for Southern Palace, nonetheless sought to impress upon me that Mr Hassim, who had, as has been pointed out, already contributed vast sums towards companies in the Realcor group in order to save them from E winding-up, was prepared to commit a further amount of R120 million to that end. He was apparently prepared to provide a guarantee in respect thereof to the various creditors of the respondent. These creditors included the 12 month debenture holders, to whom an aggregate of approximately R27 million was owed.

F [18] It was not clear to me how the *spes* of a commitment made from the bar by counsel on Mr Hassim's behalf could assist me in considering whether to exercise the discretion in terms of s 131(4) of the new Act to grant the business rescue application. Mr *Saint*'s suggestion was that, in considering the exercise of such a discretion, some weight was to be G attached to the fact that a similar discretion would in due course be exercised by the proposed business rescue practitioner to be appointed in accordance with the provisions of s 141(1) of the new Act. What the submission entailed was that this court's discretion which it was asked to exercise was, in some way, to be shared with the proposed business H rescue practitioner. I found this proposition startling — such

an approach would entail some type of delegation by this court of its statutory discretion to a person not yet appointed as business rescue practitioner. It clearly seeks to place the cart before the horse.

[19] In terms of s 131(4) of the new Act, a court may make an order placing a company under supervision and commencing business rescue I proceedings if the court is satisfied that:

[19.1] The company is financially distressed;

[19.2] the company 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

J [19.3] it is otherwise just and equitable to do so for financial reasons,

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Eloff AJ

and there is a reasonable prospect for rescuing the company; or, it may A dismiss the application, together with any further necessary and appropriate orders, including an order placing the company under liquidation.

[20] The meaning of the term 'reasonable prospect' as used in this subsection falls to be considered. In terms of s 427(1) of the previous B Companies Act 61 of 1973, a rather cumbersome and ineffective procedure was provided for reviving ailing companies. That section of the 1973 Companies Act used the phrase 'reasonable probability' in respect of the recovery requirement. It read:

'(1) When any company by reason of mismanagement or for any other cause — C

(a) is unable to pay its debts or is probably unable to meet its obligations; and

(b) has not become or is prevented from becoming a successful concern,

and there is a reasonable probability that, if it is placed under judicial management, it will be enabled to pay its debts or to meet its D obligations and become a successful concern, the Court may, if it appears just and equitable, grant a judicial management order in respect of that company.'

[21] In contrast, s 131(4) of the new Act uses the phrase 'reasonable prospect' in respect of the recovery requirement. The use of different E language in this latter provision indicates that something less is required than that the recovery should be a reasonable probability. Moreover, the mind-set reflected in various cases dealing with judicial management applications in respect of the recovery requirement was that, prima facie, the creditor was entitled to a liquidation order, and that only in exceptional circumstances would a judicial management order be F granted. The approach to business rescue in the new Act is the opposite — business rescue is preferred to liquidation.

[22] However, even if the substantive test with its lower threshold is satisfied, the court still has a discretion not to grant the order. In G exercising this discretion the court should give due weight to the legislative preference for rescuing ailing companies if such a course is reasonably possible. It would therefore be inappropriate for a court faced with a business rescue application to maintain the mind-set (from the earlier regime) that a creditor is entitled *ex debito justitiae* to be paid or to have the company liquidated. H

[23] Reverting to the instant case, it is significant that the board of directors of the respondent did not itself initiate business rescue proceedings under s 129 of the new Act. But, more importantly, there is, on the vague and undetailed information before me, no reason to believe that there is any prospect of the business of the respondent being I restored to a successful one. There is not even a concrete plan available for consideration. The previous plan of Mr Hassim failed, and there is not as yet any reason to believe that another plan will yield any better result. There is, of course, nothing that will preclude Southern Palace from renewing its business rescue application in the future, once Mr Hassim conceives of and produces a new business rescue plan. J

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Eloff AJ

A [24] While 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 B prospect of being sustainable. A business plan which is unlikely to achieve anything more than to prolong the agony, ie 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:

C [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, D 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;

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

[25] In relation to the alternative aim referred to in s 128(1)*(b)*(iii) of the new Act, being to procure a better return for the company's creditors and shareholders than would result from the immediate liquidation F thereof, one would expect an applicant for business rescue to provide 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. It is difficult to see how, without such details, a court will be able to compare the scenario G sketched in the application with that which would obtain in an immediate liquidation of the company. Mere speculative suggestions are unlikely to suffice.

[26] In the instant case, the only information of any value that was provided to me was that contained in the affidavits of Zoneska and the H Registrar of Banks. The picture painted therein as to, for instance, the likely amount that will be required in order to enable the respondent to complete the construction of the hotel, and to commence with its intended business, rendered it clear that, unless Mr Hassim was prepared to contribute at least double the amount apparently offered by I him on extremely liberal terms as to repayment, there was no reason to believe that the respondent had any prospect of becoming a successful trading concern. Unsurprisingly, other than the vague and undetailed commitment offered on behalf of Mr Hassim by Mr *Saint* from the bar, no such offer came about, and no indication as to the basis upon which Mr Hassim would be prepared to share his bounty with the respondent J emerged from the papers or during the hearing.

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Eloff AJ

[27] It was not sought, in the business rescue application, to pursue the A second aim highlighted in s 128(1)*(b)*(ii) of the new Act, namely to implement a business plan that would result in a better return for the respondent's creditors or shareholders than would result from the immediate liquidation thereof.

[28] In the circumstances, I was not prepared to exercise the discretion B provided for in terms of s 131(4) and I dismissed the application for business rescue with costs on 28 October 2011, and placed the respondent in provisional winding-up.

Applicant's Attorneys: *Gattoo Attorneys Inc*, Johannesburg; *Ince Wood & Raubenheimer*, Cape Town. C

Attorneys for First Intervening Party: *Webber Wentzel*.

Attorneys for Second Intervening Party: *Duvenage & De Villiers*, Wellington. D

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1 To be found in Part 5.3A of the 2001 Australian Corporations Act, as amended in 2007.
2 See the definition of 'business rescue' in s 128(1)*(b)* of the new Act.
3 Cassim et al *Contemporary Company Law*, 2011, at 783.
4 See s 128(1)*(b)*(iii) of the new Act.
5 Dr Colin Anderson 'Viewing the Proposed South African Business Rescue Provisions from an Australian Perspective' 2008 (1) *Griffiths Business School Journal* at 8.

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