Aantekeninge/Notes

When does an application for business rescue proceedings suspend liquidation proceedings?

1 Introduction

Section 131 of the Companies Act 71 of 2008 (the "Act") regulates the commencement of business rescue proceedings by an order of court. In terms of section 131(1) an affected person may apply to court at any time for an order placing a company under supervision and commencing business rescue. "Affected person" is defined in section 128 as a shareholder or creditor of the company, a registered trade union representing employees of the company or the representatives of employees not affiliated to a trade union. It may happen that affected persons would wish to approach the court with an application to commence business rescue proceedings after liquidation proceedings had already commenced. The Act makes provision for this circumstance in section 131, which states amongst other things that such an application, if brought, would have the effect of suspending the liquidation proceedings.

Just more than three years have passed since the Act became operational. The application of the provisions of section 131, innocuous as they may seem at first glance, is cause for concern. The contention centres around the meaning and interpretation of the term "liquidation proceedings" and the crux of the matter is whether this refers to proceedings in court (up to the point where a liquidation order has been granted), whether it encompasses winding up proceedings after a liquidator has been appointed and put in control of the company's assets, or indeed whether it refers only to that part of the proceedings that follows upon the liquidation order to the exclusion of proceedings preceding it.

The Act does not define the concept "liquidation proceedings" and court decisions that grappled with its meaning in this context have reached divergent conclusions. This note seeks to highlight the discrepancies that have arisen because of this. With reference to the stated aims and outcomes of the Act, the law of insolvency and the law governing the interpretation of statutes, an appropriate solution to the inconsistencies will be debated.

2 The Relevant Statutory Provisions

Business rescue can be initiated either by means of a company resolution (s 129), or by court order (s 131). A company resolution may however not be adopted once liquidation proceedings have been

initiated by or against the company (s 129(2)(a)). I If liquidation proceedings have already commenced business rescue can only be initiated by means of a court order obtained either by an affected person that brings the necessary application in terms of section 131, or by the court during the course of liquidation proceedings (s 131(7)).

In terms of section 131(4) the court may, on application brought by an affected person, make an order placing the company under supervision and commencing business rescue proceedings, if it is satisfied that the company is financially distressed, 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 it is otherwise just and equitable to do so for financial reasons. In addition, there must be a reasonable prospect for rescuing the company. Alternatively, the court may dismiss the application and make any further necessary and appropriate order which includes an order placing the company under liquidation.

Should the court decide to place the company under supervision and to commence business rescue proceedings as provided for in section 131(4), it has the power to make an order for the appointment of an interim practitioner nominated by the affected person who brought the application.

Section 132 (1) (c) confirms that:

> "Business rescue proceedings begin when during the course of liquidation proceedings, or proceedings to enforce a security interest, a court makes an order placing the company under supervision".

Section 131(6) provides as follows:

> "If liquidation proceedings have already been commenced *by or against the company* at the time an application is made in terms of subsection (1), the application will suspend those liquidation proceedings until – (a) the court has adjudicated upon the application; or (b) the business rescue proceedings end, if the court makes the order applied for". (Own emphasis added).

Section 131(7) in turn provides as follows:

> "In addition to the powers of a court on an application contemplated in this section, a court may make an order contemplated in subsection (4), or (5) if applicable, at any time *during the course of any liquidation proceedings* or proceedings to enforce any security against the company". (Own emphasis added).

3 Application of Section 131

The first noteworthy decision to consider the interpretation of and interaction between the subsections of section 131 is *Van Staden v Angel Ozone Products CC (In Liquidation)* (2013 4 SA 630 (GNP)). In this instance, a final liquidation order had been obtained prior to 1 May 2011 (the latter being the date on which the 2008 Companies Act became operational).

The applicant, as the only member of the close corporation in liquidation, approached the court as an affected person in terms of section 131(4) of the Act for an order to initiate business rescue. The close corporation was at that stage not yet finally wound up and deregistered. The court was thus called upon to determine whether the term "liquidation proceedings" found in section 131 of the Act could be interpreted to include the winding up process after a liquidator had been appointed. It was argued on behalf of the respondent that "liquidation proceedings" should not be equated with "winding up proceedings" and that an application to place a company under business rescue could be brought during the course of the former but not during the course of the latter. In other words, the respondent contended that liquidation proceedings come to an end once a final liquidation order had been granted, whereas winding up proceedings conclude once the Master approves a final liquidation and distribution account.

Legodi J agreed that a distinction could be made between liquidation and winding up proceedings, where the former denotes legal proceedings before a court of law and the latter the process as overseen by the Master. He concluded however that the winding up proceedings should be seen as a continuation of the liquidation proceedings and that "put simply, you do not grant a final liquidation order and execute on it. You execute on a confirmed liquidation and distribution account. Winding up proceedings are part and parcel of the liquidation proceedings" (par 27 at 625). The court would therefore be able to convert liquidation proceedings into business rescue proceedings regardless how far the liquidation and winding up proceedings might have progressed. This was unlikely to prejudice creditors as the court had the authority to appoint an interim business rescue practitioner to take control of the company amongst other things.

The legal consequences of an application for business rescue itself were not discussed and nowhere did the court conclude outright, that winding up proceedings are suspended by the bringing of the application for business rescue *ex lege* even after the final liquidation order had been awarded. However, the decision seems to have been based on subsection 131(7), as the court clearly envisaged the appointment of an interim practitioner which is done in terms of this subsection.

Following this, a slightly different set of facts presented themselves in the matter of *ABSA Bank Ltd v Summer Lodge (Pty) Ltd, ABSA Bank Ltd v JVL Beleggings (Pty) Ltd, ABSA Bank Ltd v Earthquake Investments (Pty) Ltd* (2014 (3) SA 90 (GP).

In this instance the applicant applied for the liquidation of the three respondents who were all hopelessly insolvent. On the day of the hearing an application to place the company under business rescue was brought by affected persons in terms of section 131 of the Act. The court was then asked to suspend proceedings as per section 131(6) of the Act.

As far as the meaning of the phrase "[i]f liquidation proceedings have already commenced" is concerned, the respondents argued that it should be regarded to mean "[i]f an application for the liquidation of a company has already been filed, but not yet considered" (par 10). Apart from this, a second question was whether an application for a liquidation order which has not been adjudicated upon could be seen to have "commenced" liquidation proceedings, or whether such proceedings are only seen as having been commenced after the order had been obtained (par 13).

The court (per Van der Bijl AJ) concluded that "what section 131(6) means is that once liquidation proceedings have commenced by the granting of a liquidation order, whether provisional or final, the mere issue and service of a business rescue application would suspend the liquidation process" (par 18). In other words, an application for business rescue, as referred to in section 131(6), would only suspend liquidation proceedings if a provisional or final order had previously been granted. In support of this the court relied on *Firstrand Bank Ltd v Imperial Crown Trading* 143 (*Pty) Ltd* 2012 (4) SA 256 (KZD), where Swain J considered the interpretation of the word "initiated" as used in section 129 (which bars a company from initiating business rescue proceedings by means of a company resolution once "liquidation proceedings had been initiated by or against the company").

Importantly Van der Bijl AJ expressly stated that it was not the intention of the section to discharge or set aside a liquidation order but merely to suspend the order so as to delay the implementation thereof. The judge emphasised that the section cannot have the effect that the company can proceed carrying on business (par 19).

On the return date the matter was heard by Makgoba J, who agreed with this conclusion *(ABSA Bank Ltd v Summer Lodge (Pty) Ltd, ABSA Bank Ltd v JVL Beleggings (Pty) Ltd, ABSA Bank Ltd v Earthquake Investments (Pty) Ltd*, unreported judgment, neutral citation [2013] ZAGPPHCS44 (23 May 2013). The judge concluded that the outcome of proceedings would turn on the interpretation of the phrase "liquidation proceedings" as found in section 131(6). The court considered the ordinary grammatical meaning of the words "liquidation" and "proceedings" and concluded that "'liquidation proceedings' in section 131(6) of the Act is concerned with the actual process of winding-up followed by the liquidator and the master after the winding-up order has been granted. It therefore excludes the legal action and/or process taken in order to obtain such a state of affairs". (par 11)

In further support of this conclusion the court pointed out that the legislature chose to use the word "commence" as opposed to the word "launch" or "start". The court distinguished the term "commence" as it is used in section 131(6) from its use in section 348 of the Companies Act 61 of 1973. The latter was a deeming provision, dependent on a final liquidation order being granted. Makgoba J concluded that:

> "[i]n the context of the present case I am of the opinion that section 131(6) of the Act means that once the liquidation proceedings have commenced by the granting of a liquidation order, whether provisional or final, the mere issue and service of a business rescue application in terms of section 131(1) of the act would suspend the liquidation process" (par 16).

ABSA Bank v Summer Lodge (Pty) Ltd was followed in *ABSA Bank Ltd v Makuna Farm CC* 2014 (3) SA 86 (GJ), even under circumstances where it was uncontested that the respondent was "profoundly insolvent and liable to be wound up" (par 3). Boruchowitz J specifically agreed with the court *a quo*'s conclusion that the effect of the suspension could not be such that the company would continue to do business (par 8).

A most recent decision, *Richter v Bloempro CC and Others* 2014 (6) SA 38 (GP), interprets the provisions differently. Bam J held that business rescue proceedings and a final liquidation order are different and mutually exclusive concepts. He concluded that subsection (6) could not have the effect of suspending liquidation proceedings after a final liquidation order had already been obtained for a number of reasons. Firstly, section 131 demands that business rescue should have the likely result of the company being able to continue as a viable concern or alternatively at least that it should result in a better return for creditors. The court giving the final liquidation order has already concluded that the company is in fact insolvent and at the moment unable to pay its debts. This is incompatible with the definition of 'financial distress' in section 128 which clearly states that a company is financially distressed when it is likely to become insolvent or unlikely to be able to pay its debts as they become due in the ordinary course of business in the near future (par 18).

Secondly, the Bam J concluded that the legislature would have stated clearly that section 131(6) refers also to a company under liquidation. He was therefore reluctant to accept that liquidation proceedings could effectively be converted into business rescue even after a final liquidation order was granted because of the absence of an express provision for such a process. The court finally pointed out that a final liquidation order strips a company of its original status; "[t]he company, in itself, has no locus standi anymore. It cannot operate without an order of court, or the Master's rulings or decisions of the liquidators. If it was the intention that a final liquidation order can be suspended by business rescue proceedings, it would mean that an interim order of business rescue may substitute the final liquidation order. This seems to be untenable" (par 18).

4 Analysis of the Current Position

In summation, the courts seem to have accepted that an application for business rescue will serve to suspend liquidation proceeding even after a final liquidation order had already been granted and the company placed in the hands of a liquidator. This is not necessarily the most desirable outcome and the divergent stance taken by Bam J in *Richter v Bloempro*

CC and Others is perhaps to be preferred (for the reasons given by the court along with those discussed hereafter).

Section 132(1)(c) states that business rescue proceedings will commence only when a court makes an order placing the company under supervision. To accept that a mere application for business rescue would suspend liquidation proceedings *ex lege* could yield manifestly unjust results. Such an interpretation would create an unforeseen chasm in instances where a liquidation order had already been granted and an application for business rescue is brought, as will be explained below.

It is contended that the wording of section 131 leans itself toward a more realistic interpretation. Section 131(6) refers to liquidation proceedings that have been commenced *by or against the company*. Proceedings "by or against the company" logically cannot refer to liquidation proceedings by the liquidator. The words more likely refer to proceedings by or against the company *before a court* as contemplated in section 81 of the Act (in the case of a solvent company) or in terms of Schedule 5, Item 9 (in the case of an insolvent company).

The wording of section 131(6) differs significantly from that of section 131(7). The latter refers to an application that is brought "during the course of any liquidation proceedings". This stands in contrast to section 131(6) which refers to "liquidation proceedings by or against the company". Section 131 thus seems to draw a distinction between liquidation proceedings by or against the company (which may or may not lead to a liquidation order being granted), and liquidation proceedings that gave rise to a final winding-up order and the winding-up process thereafter (which is a continuation of the liquidation proceedings).

Thus interpreted, in terms of section 131(6) the bringing of an application in terms of section 131(1) will suspend liquidation proceedings that are pending before court: The application for winding-up will stand over until the business rescue application had been heard.

This view is shared by Meskin and explained by the author as follows:

> "The question that arises is whether the term 'at any time during the course of any liquidation proceedings' in subsection (7) refers only to the time during which an application for the liquidation of a company is before the Court, i.e. prior to the Court granting a final liquidation order (as the reference to 'liquidation proceedings' in subsection (6) clearly envisages …" (Henochsberg on the Companies Act 2008 at page 474).

Once a liquidation order has been granted, the bringing of an application for business rescue will not be suspended; liquidation proceedings will continue until such time as the court grants an order as contemplated in section 132(1)(c). In the absence of such an order, the court does not have the power to hand control of the business to a business rescue practitioner. This also accords with the use of the term "liquidation proceedings" in section 129.

The interpretation of section 131 was also considered by the Kwazulu-Natal High Court in *Taboo Trading 232 (Pty) Ltd v Pro Wreck Scrap Metal CC and others; Charles Theodorus Joubert and Pro Wreck Scrap Metal CC* (2013 (6) SA 141 (KZP)). The court did not consider at which stage of the process an application commencing business rescue would suspend liquidation proceedings, but focussed instead on what could be considered circumstances that would render liquidation proceedings suspended. The question identified by the court was how to interpret the phrases "at the time an application is made" as per section 131(6), and "an affected person applies" as per section 132(1)(b). Hartzenberg AJ pointed out that two possible interpretations present themselves, namely that the mere lodging with the Registrar and issuing of the business rescue application constitutes a triggering event suspending liquidation proceedings or alternatively, that due compliance with the service and notification requirements of subsections 131(2)(a) and (b) is also required.

The court concluded that the latter interpretation is the correct one, and that a business rescue application is only to be regarded as having been made once the application has been lodged with the Registrar, duly issued, a copy thereof served on the Commission and each affected person has been properly notified of the application. After considering a number of relevant decisions, the judge correctly, in my respectful opinion, points out that the:

> "Suspension of the liquidation proceedings as contemplated by s 131(6) of the Companies Act, has significant consequences, in the context where liquidation proceedings had already commenced. Clearly, such suspension may and probably will in most instances have a disruptive effect on the liquidation proceedings. Any delay of the hearing of a pending liquidating application, may in some instances have the result that a company or close corporation continue trading in insolvent circumstances. The purpose of the notification required by section 131(2)(b), is to facilitate participation in terms of s 131(3), by affected persons in the hearing of the business rescue application. Creditors, being affected persons, in the business rescue application, also have a material interest in the liquidation proceedings … There is a strong policy justification for interpreting these provisions in a way which would not facilitate a dilatory or supine approach by an applicant in business rescue proceedings" (par 11).

This is a sound approach to interpreting section 131 in general. To some extent, business rescue must surely override liquidation proceedings to give effect to the accepted idea that it is preferable to save a viable enterprise rather than to liquidate it (Cassim et al *Contemporary Company Law* 790). This seems to be what the courts are currently focussed on, and it is indeed commendable (see for example *Cardinet (Pty) Ltd v Wedgewood Golf and Country Estate (Pty) Ltd and others* (unreported case No 19599/2012 Western Cape High Court)). However a regime that would sacrifice certainty and business efficiency at the altar of business rescue does not present a viable alternative. Most recently, the Supreme Court of Appeal reiterated the role of the court when

interpreting the language of legal documents. The following remarks are of particular significance to the discussion at hand:

> "Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. The process is objective, not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. Judges must be alter to, and guard against, the temptation to substitute what they regard as reasonable, sensible or businesslike for the words actually used. To do so in regard to a statute or statutory instrument is to cross the divide between interpretation and legislation; in the contractual context it is to make a contract for the parties other than the one they in fact made. The 'inevitable point of departure is the language of the provision itself', read in context and having regard to the purpose of the provision and the background to the preparation and production of the document" (*Natal Joint Municipal Pension Fund v Edumeni Municipality* 2012 4 SA 593 (SCA) par 18 at 603 F – 604 D).

5 Conclusion

One of the clear purposes of the Act was 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*" (s 7(k), emphasis added). On the one hand, this necessarily means a system that encourages corporate management and a return thereto sooner rather than later. It would also require agility and accessibility to the greatest extent possible. On the other hand, the legislature was clearly careful to avoid a regime that would allow defaulting debtor companies to use business rescue proceedings in an underhanded manner in order to defraud or frustrate their creditors. This is apparent if one considers, amongst other things, the fact that affected persons may oppose a company resolution to initiate business rescue (s 130) and the extensive degree of oversight that creditors are given during the course of proceedings (See in general: Richard Bradstreet *The New Business Rescue: Will Creditors Sink or Swim* 2011 (2) *SALJ* 352). Clearly this is also why a company may no longer initiate business rescue proceedings by means of a company resolution after liquidation proceedings have been commenced.

Naturally an application brought during the process of liquidation proceedings prior to the granting of a final liquidation order should suspend same. The court has not yet ruled whether or not a liquidation order should be granted and might well conclude that business rescue is to be preferred. The initial managers of the company are at this stage still

in control of the business and the creditors as affected persons are given the necessary opportunity to convince the court of the most preferable outcome (even if an application for business rescue is brought subsequent to an application for liquidation). After the liquidation order has been obtained the matter effectively, is no longer before the court. If the court decides to make an order to initiate business rescue after a final liquidation order had been obtained, this has to be done in terms of section 131(7) which provides for the appointment of an interim practitioner and therefore does not create the unfortunate limbo currently in place. An application is at times brought weeks, if not months, before it is heard. Should the mere lodging and servicing of the application suspend liquidation proceedings *ex lege*, the consequences would be that the assets would revert to the initial managers which could have an extensive and potentially devastating impact on the rights of creditors.

It is noteworthy that this exact type of abuse came before the court in *Janse van Rensburg NO and another v Cardio Fitness Properties (Pty) Ltd and others* [2014] JOL 31979 (GSJ), where Kgomo J held that the suspension of liquidation proceedings will not divest the liquidator of control over the assets of the company. The judge agreed with the applicants in the matter that the suspension of the liquidation proceedings did not also suspend the appointment of the joint liquidators therein. This was due to the fact that section 131(6) was silent as to its effect on the powers of the liquidators and in the view of the court the legislature would have stated "clearly and unambiguously" if it intended that the provisional liquidators should be relieved of control before the appointment of a business rescue practitioner (par 52). In the words of Kgomo J "it was not the intention of the legislature that the first respondent at any stage be a rudderless ship or ship without captain" (par 56). This interpretation would indeed address some of the concerns that the current position brings to the fore. However, the fact that the liquidators might be left unable to act and the delays and costs of abusive litigation might be every bit as detrimental, as Sutherland J rightly points out in *ABSA Bank Ltd v Newcity Group (Pty) Ltd, Cohen v Newcity Group (Pty) Ltd and Another* [2013] 3 All SA 146 (GSJ).

It would be naïve to imagine that desperate managers (who are often also shareholders or creditors and thus "affected persons") would not be tempted to use a business rescue application in an abusive manner and perhaps to approach the court only to frustrate a viable application to have the company liquidated. In fact, even a misguided application that has no merit, brought by a *bona fide* affected person could undermine the integrity of liquidation proceedings. Such abuses would be difficult if not impossible to rectify. In contrast, , the potentially negative consequences of successful liquidation proceedings where a company is a prime candidate for business rescue could be addressed by bringing the application for business rescue on an urgent basis. No prejudice could result from this, as the court would then, on an urgent basis, be able to make an order as envisaged in section 131(7). The creditor that obtained

the liquidation order would be at liberty to make out a case for liquidation and the court would be able to consider the merits of the business rescue application before it has a significant impact on liquidation proceedings.

Finally, the much talked about failure of 1Time Airlines early in 2013, following unsuccessful business rescue proceedings, emphasises the stark reality that the business rescue regime introduced by the Act is no silver bullet. Although heralded as an improvement on its predecessor, there will likely be numerous companies who will not survive in spite of attempted rescues. It is for this reason that it is perhaps wise to remember one of the underlying principles of the law of insolvency, and to consider the impact that the current position might have in the light thereof. Innes CJ explains the concept of a *concursus creditorum* as follows:

> "The object of the [Insolvency Act] is to ensure a due distribution of assets among creditors in the order of their preference ... The sequestration order crystalizes the insolvent's position; the hand of the law is laid upon the estate, and at once the rights of the general body of creditors have to be taken into consideration. No transaction can thereafter be entered into with regard to estate matters by a single creditor to the prejudice of the general body. The claim of each creditor must be dealt with as it existed at the issue of the order" (*Walker v Syfret NO* 1911 AD 141 166).

Once the hand of the law is laid upon the estate, surely a mere application should not be able to dislodge it? It is submitted that the current interpretation of section 131 should be reconsidered to ensure that the existing dissonance is better addressed. It is respectfully submitted that the conclusion reached by Bam J in *Richter v Bloempro CC and Others* appears to be the correct one.

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