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# DISPUTE RESOLUTION ALERT

## IN THIS ISSUE >

### The abuse of business rescue proceedings in the aftermath of the COVID-19 pandemic: A debtor's paradise?

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## The abuse of business rescue proceedings in the aftermath of the COVID-19 pandemic: A debtor's paradise?

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Essentially, business rescue offers a rehabilitation process to companies in financial distress. At its best, business rescue creates a much-needed "win-win" solution for all the affected parties. At its worst, business rescue is used as a means to frustrate creditors from exercising their rights. Unfortunately, in the economic aftermath of the COVID-19 pandemic, more and more companies will resort to business rescue proceedings as a means to seek refuge from creditors even if the facts do not justify this. A typical example can be found in the recent judgment of *Standard Bank of South Africa Limited v C and E Engineering (Pty) Ltd And Others* [2020] ZAGPJHC 255 handed down by the Johannesburg High Court on 14 August 2020.

The facts of the case were as follows: C and E Engineering (Pty) Ltd (Company) entered into five facility agreements (collectively referred to as the "agreement") with Standard Bank. Standard Bank held, among other forms of security, a cession of the Company's book debts and a General Notarial Bond over all of the Company's movable property. Things quickly took a turn for the worse when the Company breached the agreement, becoming indebted to Standard Bank to the tune of R44 million.

Standard Bank brought an urgent application for a perfection order on an *ex parte* basis, stating that it feared that the Company might resort to placing itself under business rescue. The perfection order was granted on 14 July 2020 with a return date for the order to be confirmed as final at a later stage.

### Cue the smoke and mirrors

Standard Bank was missing a crucial piece of information: The directors of the Company had already passed a resolution to commence business rescue proceedings. The resolution was accompanied by sworn statements from the directors, with the effect that as from 7 July 2020, the Company was in business rescue. To make matters worse, the board of directors, realising that the Company had reached a cul-de-sac, transferred an amount in excess of R1,8 million from an overdraft account held with Standard Bank to certain entities associated to the directors.

### Dual applications

The Court had to consider two related and urgent applications: firstly, the Company's application to have the perfection order obtained by Standard Bank discharged. Secondly, Standard Bank's application calling for the Court to set aside of the directors' resolution placing the Company under business rescue and to convert the business rescue to provisional liquidation.

## The abuse of business rescue proceedings in the aftermath of the COVID-19 pandemic: A debtor's paradise?...continued

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### Validity of the board resolution

The Court deemed section 130(5) of the Companies Act, 2008 particularly relevant to the case. This section relates to the circumstances when a court may set aside a board resolution placing a company under business rescue. In considering this issue, the Court placed great emphasis on whether it would be just and equitable to do so, taking into account whether there were reasonable prospects of rescuing the Company, and the *bona fides* of the Company's conduct.

The Court found that the correspondence between the parties indicated that the Company was reliant on the continued use of the overdraft facility, or its book debts, in order to continue to trade, and more particularly, on Standard Bank's willingness to extend further financial support under the agreement.

It was common cause that Standard Bank had already indicated that it would not be prepared to extend any further facilities to the Company. Thus, there was no prospect of post-commencement finance being extended by Standard Bank. The only other possible financial injection would be from the collection of book debts, which would require Standard Bank's consent - consent Standard Bank expressly stated it would not give.

The Court also pointed out that in the directors' sworn statements they failed to state that there were reasonable prospects of rescuing the Company - a fundamental statutory requirement for business rescue.

The Court thus found that there was simply nothing placed before it to support the conclusion that the company could be rescued, let alone a reasonable prospect of such rescue.

### Should the Company's business rescue continue or be terminated?

On the second issue, the Court stated that there were strong indications that the Company's board resolution was not adopted *bona fide*. Prior to the commencement of business rescue, the Company and Standard Bank were involved in ongoing negotiations to reach agreement on how the Company could meet its obligations under the agreement. The Company had not honoured its previous proposals. Nonetheless, during their negotiations, the parties seemed to have found some prospect of reaching a solution. Instead of pursuing it, the Company's directors adopted the resolution without reverting to Standard Bank.

The Court found that there was sufficient evidence placed before it to conclude that there was a deliberate tactic on part of the directors to secretly adopt the resolution in order to obstruct Standard Bank in the exercise of its rights. This inference was reinforced by the fact that the directors failed to inform Standard Bank that the Company was in business

## The abuse of business rescue proceedings in the aftermath of the COVID-19 pandemic: A debtor's paradise?...*continued*

While business rescue envisages noble objectives such as ensuring the continued existence of a financially distressed company, and the preservation of valuable jobs and so on, the abuse of the process often results in creditors being left out of pocket.

rescue even when they became aware of Standard Bank's perfection order. Moreover, and very significantly, the directors transferred R1,8 million from the Company's overdraft account after the resolution had been adopted, further increasing Standard Bank's exposure to the Company.

The Court concluded that it was just and equitable to set aside the resolution, thereby terminating business rescue proceedings. At the same time, the Court confirmed the perfection order as final.

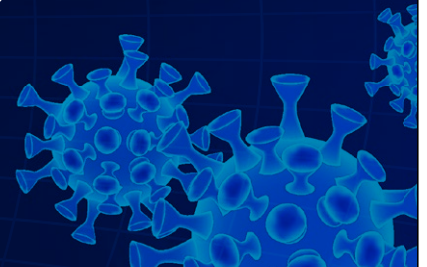
### Conclusion

This case raises questions of whether the statutory framework governing business rescue sufficiently protects creditors from abuse without them having to resort to our courts for recourse. While business rescue envisages noble objectives such as ensuring the continued existence of a financially distressed company, and the preservation of valuable jobs and so on, the abuse of the process often results in creditors being left out of pocket. This needs to be addressed by legislature.

*Mongezi Mpahlwa and  
Thato Maruapula*

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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