Abuse of business rescue proceedings

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Although business rescue may be a good tool for the purpose of turning around financially distressed businesses, it also opens the door for abuse by unscrupulous debtors.

A business rescue application may be brought at any time during liquidation proceedings, even after a final winding-up order has been granted, right up until the point where a final liquidation and distribution account is confirmed by the Master of the High Court.

In terms of section 131(6) of the Companies Act 71 of 2008, if an application to commence business rescue proceedings is launched at any time after liquidation proceedings against a company have commenced, such liquidation proceedings shall be suspended until:

• The court has adjudicated upon the business rescue application; or
• The business rescue proceedings end, if the court makes the order applied for.

Accordingly at any stage of the liquidation proceedings, a business rescue application to court will have the effect of staying the liquidation proceedings. The consequences of this could be prejudicial to creditors. Among other things, it could result in lengthy delays to the detriment of creditors and therefore opens up the door for abuse.

An example of one such abuse would be the use of a business rescue application to interrupt a pending insolvency enquiry into the affairs of the company in liquidation.

An insolvency enquiry held in terms of sections 417 and 418 of the old Companies Act is a mechanism that entitles a creditor or creditors to interrogate witnesses and investigate the affairs of the company. It is a crucial tool for outsiders, such as the liquidators and/or creditors, to gather evidence about the reasons for failure of the company, to determine whether any voidable dispositions were made prior to liquidation and whether the directors and officers were party to conducting the business in a reckless and/or fraudulent manner. The conducting of such enquiry, however, hinges upon the company being in liquidation. It is not possible to convene or continue such an enquiry without the company being in liquidation. The business
rescue provisions in Chapter 6 of the new Companies Act do not contain any mechanism equivalent to an insolvency enquiry.

A question that arises is whether it is competent to convene an insolvency enquiry for the purpose of investigating the affairs of a company in the event where a company has been placed in liquidation, but where a business rescue application has been brought, subsequent to the granting of the final liquidation order.

Section 131(6) makes it clear that all liquidation proceedings shall be suspended at the time when an application for business rescue is brought to court. This was confirmed in the case of Cohen v Newcity Group (Pty) Ltd. The effect of this surely must be that all rights flowing from a liquidation order must also be suspended. Therefore it flows naturally that it is not competent to proceed with an insolvency enquiry in the event where liquidation proceedings have been suspended by virtue of an application for business rescue. It must be noted that the event where a liquidation order is granted while an application for business rescue is being adjudicated will be of little assistance to creditors. The important aspect for creditors is not the actual liquidation order, but rather the winding-up process after the order has been granted. In such circumstances and as stated above, the suspension of all liquidation proceedings will result in the suspension of the entire winding-up process.

The above situation is cause for concern especially where unscrupulous debtors or directors of a company can simply bring a business rescue application to court with the intention of having to avoid, interrupt or delay their own interrogation into the affairs of the company in liquidation. This becomes even more problematic where such parties are well-funded and their intentions are to drain the resources of the liquidators and/or creditors in order to avoid being held to account for their misconduct of the company's affairs. It seems as if the only available remedy against abuse of this nature is an interpretation by the courts that the winding-up process must continue despite the pending adjudication of the business rescue application, alternatively a legislative amendment to that effect.