IN THE HIGH COURT OF SOUTH AFRICA

(WESTERN CAPE HIGH COURT, CAPE TOWN)

CASE NO: 19075/11

In the matter between:

FRANCIS EDWARD GORMLEY — **Applicant**

and

WEST CITY PRECINCT PROPERTIES (PTY) LTD
(Registration Number : 2003/012428/07) — **First Respondent**
THE COMPANIES & INTELLECTUAL PROPERTY COMMISSION — **Second Respondent**

and

ANGLO IRISH BANK CORPORATION LTD
(Registration Number : 22045) — **Intervening Affected Party**

AND

CASE NO: 15584/11

In the matter between:

ANGLO IRISH BANK CORPORATION LTD
(Registration Number : 22045) — **Applicant**

and

WEST CITY PRECINCT PROPERTIES (PTY) LTD
(Registration Number : 2003/012428/07) — **Respondent**

JUDGMENT : 18 APRIL 2012

TRAVERSO, DJP:

[1] Two matters were served before me. For obvious reasons they were consolidated and heard simultaneously. The one matter (Case No. 19075/11) was an application for the business rescue of the first respondent brought by Mr. Francis Edward Gormley ("*Gormley*") the major shareholder of and a director of the first respondent. The application is brought in terms of Section 128 of the Companies Act, No. 71 of 2008 ("*the Act*"). Anglo Irish Bank Corporation Limited ("*the Bank*"), on the other hand (Case No. 15584/11), as the intervening affected party brought an application for the winding up of West City.

[2] The main thrust of Gormley's application for the business rescue of West City appears to be that there is a reasonable prospect for the rescue of West City in that, but for the capital of the Bank's loan to West City and the interest due thereon,

the first respondent will be "*factually and commercially solvent*". The entire application is therefore premised on the basis that provided the first respondent's obligations to the Bank are to be suspended, West City's income will be sufficient to cover it monthly expenses.

[3] It is common cause in both applications that:

3.1 West City is indebted to the Bank in a sum of more than R219 000 000,00.

3.2 The sum is due, owing and unpaid.

3.3 West City, by its own admission is unable to pay its indebtedness from its available resources.

3.4 West City's principle assets are sectional title units which are all mortgaged to the Bank.

3.5 The rental income and revenues from the letting of these properties has been ceded to the Bank as further security for the sum owing.

3.6 Gormley relies on certain valuations of the properties which purportedly show that they exceed the value of the liabilities of West City. On Gormley's own say so these values can only be achieved over a period of 3 to 5 years. The only logical inference of this is that the present day value of its assets is less than its liabilities and that it is therefore insolvent.

[4] To contend, as Gormley does, that the new Act does not have application because West City is solvent does not hold water. The Bank is by far the largest creditor of West City. It cannot in all honesty be suggested that a company is "*solvent*" within the meaning of the Act because its obligation to its largest creditor is suspended for a period of 3 to 5 years.

[5] This application has as its object a moratorium (of 3 to 5 years it would seem) for West City during which its assets may be disposed of – supposedly bringing about a larger dividend to creditors than would be achieved by the immediate winding up.

[6] Chapter 6 of the Act deals with the concept of business rescue. Before dealing with the merits or demerits of this application, I will briefly refer to the relevant provisions of the Act.

6.1 An application for business rescue can be brought by an affected person. It is common cause that Gormley is a affected person[1].

6.2 Business rescue has as its aim proceedings to facilitate the rehabilitation of a financially distressed company by providing for the temporary management of the affairs of the company, a

[1] Section 128(1)(b)(iii). **Application and definitions applicable to Chapter**. – (1) In this Chapter - … (b) '**business rescue**' means proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for …(iii) the 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 maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company;

temporary moratorium on the rights of claimants, the implementation of a plan to rescue the company by restructuring its affairs in a manner that maximises the likelihood of the company continuing to function on a solvent basis or if that is not possible, a plan that would achieve a better return for the company's creditors than the payment they would receive if the company were to be immediately liquidated.

6.3 Financially distressed is defined in Section 128(1)(f) as follows:

> ***"Application and definitions applicable to Chapter.-***
> ***(1) In this Chapter –***
> ***(f) "financially distressed", in reference to a particular company at any particular time, means that –***
> ***(i) it appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months; or***
> ***(ii) it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months;"***

I will return to this aspect later.

[7] The business practitioner must, after consulting the creditors, prepare a business rescue plan for consideration and possible adoption.[2] The proposal and implementation of the plan is the most important aspect of the process. The legislature has not been prescriptive as to what a business rescue plan must contain. Chapter 6 has merely created a framework within which it can be developed.

[8] All affected persons must receive notice as prescribed by the Act and the regulations.[3] Chapter 6 makes it clear that creditors have the strongest right to consultation regarding the development of a business plan. The reasons are self-evident. They, after all, have the biggest financial interest in the outcome of the proposed business rescue.

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[2] Section 150. **Proposal of business rescue plan**. – (1) The practitioner, after consulting the creditors, other affected persons, and the management of the company, must prepare a business rescue plan for consideration and possible adoption at a meeting held in terms of section 151. (2) The business rescue plan must contain all the information reasonably required to facilitate affected person in deciding whether or not to accept or reject the plan, and must be divided into three Parts, as follows:

[3] Regulation 125(3)

[9] Mr. Woodland, who appeared with Mr. Melunsky on behalf of the applicant submitted that the Court may make an order commencing business rescue proceedings if "*satisfied*" that any one of the following three situations exist:

(i) That the company is financially distressed;

(ii) 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; (It is common cause that the company has failed to pay over an amount in terms of its obligation.)

(iii) It is otherwise just and equitable to do so for financial reasons.

[10] He concedes however that in each of the abovementioned three cases it must be shown that there is a reasonable prospect of rescuing the company.

[11] Against this background I repeat, Gormley's application is based solely on the basis that if the first respondent's loan to the Bank should be "*suspended*" for a period of three to five years, the first respondent would be able to pay its creditors (with the exception of the Bank) on a day to day basis. It was also submitted that if the sectional title units could be sold in the normal course and not in a *"fire sale"* the return would be better than would be the case under liquidation. The Act envisages a short term approach to the financial position of the company. This is so for self-evident reasons. There must be a measure of certainty in the commercial world. Creditors cannot be left in a state of flux for an indefinite period. The provisions of the Act make it clear that the concept of business rescue only applies to companies which are financially distressed as defined in the Act. If a company is not so financially distressed the provisions

of Chapter 6 of the Act will not apply. It must either be unlikely that the debts can be repaid within 6 months or that there is the likelihood that the company will go insolvent within the ensuing 6 months. In this case the company is presently insolvent and cannot pay its debts unless a moratorium of 3 – 5 years is granted. The facts of this matter does not bring West City's financial situation within the definition of "*financially distressed*".[4]

[12] That should, in my view, be the end of the matter. But there are other grounds on which I consider that an order for the business rescue of West City will be inappropriate. It is apparent from both the founding and the replying affidavits of Gormley's application that the sole object of the application is to achieve a moratorium for West City during which its assets may be disposed of in order to pay what is hoped to be a larger dividend to creditors than would be achieved from the immediate winding up. But the definition of business rescue

[4] Section 1(f) of the Act.

makes it clear that a restructuring of a potentially viable company is envisaged so that it can continue to function as an economic entity. In the present case no restructuring of the company is envisaged, merely the realisation of its assets over an extended period of time. Not a single fact is placed before the Court as to why creditors can expect a larger dividend at the end of the moratorium. Only generalisations are put forward. There is no plan put forward at all and when the papers are analysed it becomes apparent that the application boils down to nothing more than the winding down of West City in a manner which disregards the rights of creditors and in particular that of the Bank are completely ignored.

[13] The *"better return for creditors"* envisaged in Section 128(1)(b)(iii) must be interpreted in context and with reference to the provisions of Section 150[5] of the Act. The practitioner can only prepare the plan once he/she has consulted, *inter alia*, the creditors. The Bank has made it clear that it will not be

[5] See fn 2

party to a plan where the remaining assets are to be sold over a period spanning 3 – 5 years. But, in any event, a viable rescue plan must contain facts which show that if the intended resuscitation of the company should fail, the creditors will not be worse off. An essential element of any business rescue is the implementation "*of a plan to rescue the company by restructuring its affairs, business, property, debt or other liabilities and equities*". Foundational therefore to any application for business rescue is a restructuring plan. It is indeed so that at this stage of the proceedings the Court is not concerned with the detail of the business rescue plan. But where the facts disclosed by the applicant reveal what the business plan will entail, the Court cannot find that, even where it is clear that no business plan as envisaged by the Act can eventuate, it is premature to express a view or to make a finding in this regard. Absent a restructuring plan, the application will not be an application for business rescue as contemplated by the legislature.

[14] In the papers no mention is made of any refinancing of West City's affairs. There is no suggestion that Gormley or anybody else is prepared to inject capital into West City. Gormely has made several attempts to raise money to refinance West City, but these attempts have hitherto resulted in nothing. He admits that the current difficult banking and property environment is not conducive to a refinancing that is commercially viable. What Gormley states in his affidavits is rather surprising. He states:

> ***"I say that the moratorium sanctioned by business rescue proceedings will enable the first respondent over a period of three to five years, to pay all its liabilities, specifically to the Bank."***

[15] It is difficult to understand on what this allegation is based. Unless there is a *bona fide* workable restructuring plan the moratorium provisions of the business rescue proceedings will lend themselves to abuse by company insiders seeking to use these provisions to frustrate creditors' rights and to stave off liquidation for motives of their own.

[16] It is clear that the scheme envisaged by Gormley will render the business rescue practitioner largely irrelevant. West City intends to trade as before and the sole agenda of the application is to obtain a moratorium and subvert the Bank's security.

[17] It is common cause that West City has been unable to pay its debts since April 2008. It is further common cause that West City's only source of income is the rent and revenue derived from the remaining sectional title properties owned by it and proceeds of the sale of such immovable properties as and when these occur. Gormley however envisages that the rent and the revenue (all of which are ceded to the Bank as security for its indebtedness) will be available to be used by West City to enable it to trade to cover its trading expenses and to pay the creditors of the Bank.

[18] From the replying affidavits, it appears that Gormley accepts that his initial view that the proceeds would accrue to

West City was wrong and that the full proceeds of the sale would accrue to the Bank in the business rescue proceedings. The moratorium on which he originally relied in terms of section 133(1) of the Act provides that no legal proceedings against the company or in relation to any property belonging to the company or lawfully in possession may be commenced during business rescue proceedings without the consent of the business rescue practitioner. The Bank's entitlement to all rents and revenue is a right which it will enforce against the third parties who owe rents and revenue. Such rents and revenue do not constitute property belonging to West City, nor are such rents and revenue in its possession nor will it ever be. The provisions of section 133(1), in my view, have no bearing on the Bank's entitlement to the rents and revenue, as the collection thereof does not constitute enforcement proceedings.

[19] All of the remaining unsold sectional title properties owned by West City are mortgaged in favour of the Bank, and each of the mortgages contain the following provision:

"15 Rents and Additional Security

15.1 Should the mortgagee give his consent to the letting of the properties as additional security for any sum that may be claimable under this bond, the mortgagor hereby cedes and assigns to the mortgagee all rents and revenues which may accrue in respect of the properties and he hereby appoints the mortgagee irrevocably and in rem suam with power of substitution at the mortgagee's option to deal in any way with the letting of the properties and to recover the rents and revenue therefrom and to cancel or renew and enter into new leases in such manner as the mortgagee may deem fit with power to take proceedings against tenants in default or ejectment and for the recovery of any amounts due by them, and to appoint agents and attorneys for this purposes provided always that these powers shall not be exercised so long as all conditions are complied with.

15.2 The mortgagee shall be entitled to charge not exceeding 10% of the gross amount of rent and revenue collected and shall deduct such commission from the amount collected before crediting the account of the mortgagor."

[20] It is common cause that the conditions of the mortgage bond were not complied with by West City and that West City has failed to pay the capital and interest due which currently amounts to R219 000 000,00. Inasmuch as Gromley has now conceded that the Bank is entitled to the revenue, I do not believe that this matter warrants any further discussion.

[21] Gormley's belief that West City will be able to sell units off gradually over the next three to five years and apply the monies to transaction costs and day to day creditors is accordingly misconceived both in terms of the mortgage bond and section 134[6] of the Act. No unit may be sold without the Bank's prior consent and in the event of the Bank consenting all of the proceeds of such sale would have to be paid to the Bank. It is common cause that West City has no further assets to provide other security to the Bank, and the Bank will not agree to any arrangement in terms whereof it does not receive the full sale proceeds of the property.

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[6] Section 134. **Protection of property interests**. – (1) Subject to subsections (2) and (3), during a company's business rescue proceedings – (a) the company may dispose, or agree to dispose, of property only – (i) in the ordinary course of its business; (ii) in a bona fide transaction at arm's length for fair value approved in advance and in writing by the practitioner; or (iii) in a transaction contemplated within, and undertaken as part of the implementation of a business rescue plan that has been approved in terms of section 152; (b) any person who, as a result of an agreement made in the ordinary course of the company's business before the business rescue proceedings began, is in lawful possession of any property owned by the company may continue to exercise any right in respect of that property as contemplated in that agreement, subject to section 136; and (c) despite any provision of an agreement to the contrary, no person may exercise any right in respect of any property in the lawful possession of the company, irrespective of whether the property is owned by the company, except to the extent that the practitioner consents in writing. (2) The practitioner may not unreasonably withhold consent in terms of subsection (1)(c), having regard to – (a) the purposes of this Chapter; (b) the circumstances of the company; and (c) the nature of the property, and the rights claimed in respect of it. (3) If, during a company's business rescue proceedings, the company wishes to dispose of any property over which another person has any security or title interest, the company must – (a) obtain the prior consent of that other person, unless the proceeds of the disposal would be sufficient to fully discharge the indebtedness protected by that person's security or title interest; and (b) promptly – (i) pay to that other person the sale proceeds attributable to that property up to the amount of the company's indebtedness to that other person; or (ii) provide security for the amount of those proceeds, to the reasonable satisfaction of that other person.

[22] In any event, it appears that this application is an exercise in futility. In terms of section 152(2)[7] of the Act, any business rescue plan must be approved by the holders of more than 75% of the creditors' voting interest. The Bank, on Gormley's own papers, holds in excess of 75% of the creditors' voting interest. West City has failed over the past three years to pay or even reduce its indebtedness to the Bank, and the Bank will not approve a business plan which involves both waiting another three to five years to be paid, and West City utilising assets securing the Bank's claim to pay West City's running expenses and West City's other creditors. That much is clear from the Bank's answering affidavit and the Bank has already rejected this notion. In terms of section 132(2)(c)[8] of the Act, the Bank's rejection of such rescue plan will therefore end the business rescue proceedings.

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[7] Section 152(2). **Consideration of business rescue plan.** - ... (2) In a vote called in terms of subsection (1)(e), the proposed business rescue plan will be approved on a preliminary basis if – (a) it was supported by the holders of more than 75% of the creditors' voting interests that were voted; and (b) the votes in support of the proposed plan included at least 50% of the independent creditors' voting interests, if any, that were voted.

[8] Section 132(2)(c). **Duration of business rescue proceedings.** - ... (2) Business rescue proceedings end when – ... (c) a business rescue plan has been – (i) proposed and rejected in terms of Part D of this Chapter, and no affected person has acted to extend the proceedings in any manner contemplated in section 153; or (ii) adopted in terms of Part D of this Chapter, and the practitioner has subsequently filed a notice of substantial implementation of that plan.

[23] In the circumstances I am satisfied that Gormley's application for business rescue should be dismissed with costs, including the costs of two Counsel.

[24] The parties were *ad idem* that if the application for business rescue fails, I should, in the exercise of my discretion grant a winding up order.

[25] In the circumstances I make the following orders:

25.1 Case No. 19075/11:

The application for business rescue is dismissed with costs, which costs shall include the costs of two Counsel;

25.2 Case No. 15584/11:

It is ordered that :

(a) the respondent is placed under provisional liquidation in the hands of the Master of

Western Cape High Court, who is directed to appoint a provisional liquidator as a matter of urgency;

(b) a Rule *nisi* is hereby issued calling upon respondent or any other interested parties to show cause, if any, on 10 MAY 2012 why the respondent should not be placed in final liquidation;

(c) service of this Order shall be effected:

(i) on the respondent at its registered office;

(ii) on the South African Revenue Services;

(iii) on the Master of the Western Cape High Court, Cape Town;

(iv) by publication of this Order in one edition of *The Cape Times* and *Die Burger* newspapers;

(v) by service of all known creditors of the respondent by registered mail with claims in excess of R5 000,00.

(d) the costs of this application shall be costs in the liquidation.

TRAVERSO, DJP