A statutory analysis of business rescue for Small and Medium Enterprises in South Africa

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SOLEMN DECLARATION

I **Thabo Elias Lekoko**, hereby declare that the mini-dissertation entitled **A statutory analysis of business rescue for small and medium enterprises in South Africa**, which is submitted in fulfilment of the requirements for the Masters of Laws degree, is the product of my research and all other works used in this research are acknowledged. I have not allowed anyone to copy this work and submit it as his or her own.

Signature of Candidate

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Signed at on this 31st day of October 2022.

Declared before me on this 31st day of October 2022.

Signature of Supervisor

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ABSTRACT

Small and Medium Enterprises (SMEs) are contributing positively to South Africa's socio-economic development. They are eradicating poverty by providing skills and job opportunities to the citizens of South Africa. However, these enterprises are often failing, which results in job losses and a lack of skills offerings. The *Companies Act* 71 of 2008 of South Africa makes provision for two methods that can be used to rescue companies which are in financial distress. These methods are governed by section 128, which follows the formal approach, and section 155, which follows the informal approach. These methods replaced official judicial management found in *Companies Act* 61 of 1973. Section 128 of the *Companies Act* 71 of 2008 provides the procedure by which a company in financial distress is placed under the supervision of business rescue practitioners. These practitioners are expected to host a meeting with management and the creditors of the company in question. After that they will draft a plan which will be used to rescue this company, and the creditors are afforded an opportunity to vote on the presented plan. During this procedure the company will be provided with an automatic *moratorium* to protect it from legal claims until the procedure is complete. However, section 155 of the *Companies Act* 71 of 2008 provides that any company may make use of this section whether they are financially distressed or not; the board of the company in question may make arrangements with or proposals to its creditors. If the proposal is accepted by creditors, then the new arrangements can be made, and if it is not accepted then the arrangements will not take place. Business rescue not only helps to save jobs but brings good returns for the creditors of the company in question. This mini-dissertation analyses the current business rescue procedure provided for by the *Companies Act* 71 of 2008, to establish whether it is suitable for SMEs in South Africa.

Keywords: business rescue, small and medium enterprises (SMEs), business rescue practitioners, financial distress, insolvency, liquidation, moratorium, and restructuring.

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CHAPTER 1

1. INTRODUCTION

1.1 Background of the study

The business rescue method was introduced in the current legislation called *Companies Act* 71 of 2008 (hereinafter referred to as the 2008 *Companies Act*). The definition of this method is found in section 128(1)(b) of the 2008 *Companies Act* as a process by which a financially distressed company is rehabilitated by the provision of temporary observation to manage the company's affairs and rescue it from liquidation. Similarly, the company to be rescued must be registered in terms of the *Companies Act* 61 of 1973 (hereinafter referred to as the 1973 *Companies Act*) or the 2008 *Companies Act*. The business rescue process may be initiated by affected persons such as secured and unsecured creditors, employees, and shareholders according to 128(1)(f) of the 2008 *Companies Act*, when there is a belief that the company will be insolvent in the upcoming six months If there is no intervention, and there is a chance that this company can recover from its dire financial position.

When the court is satisfied with this application, it will grant an order for business rescue and later appoint a business rescue practitioner. The practitioner must restructure the company in question. A company which is under this process is immune from legal claims, provided for by the principle of a *moratorium*. If this process succeeds, the interests of the affected persons, such as the employees, unions of the employees, government and employers, will be protected. However, if this process does not succeed then it means the company will be insolvent and has to be dissolved.

Business rescue is available for all companies including small and medium enterprises (hereinafter referred to as SMEs). In the case of *Koen v Wedgewood Village Golf Estate (Pty) Ltd and Others*,[1] the court held that business rescue aims

[1] (24850/11) [2011] ZAWCHC 464; 2012 (2) SA 378 (WCC) (9 December 2011).

to protect the interest of the public by steering financially distressed companies away from liquidation. Moreover, South Africa provides SMEs with a large platform for these enterprises to grow, since they are important for economic development and reduction of the unemployment rate. For example, South Africa provided a platform for the partnership of companies called Vcita and Helplink Africa to help grow SMEs.[2] Interestingly, this country has a greater number of SMEs compared to large businesses and this number increases every year as more SMEs are established.[3] Therefore, South Africa has a big responsibility to protect these enterprises to ensure job security and promote a fast-growing and healthy economy.

In this country, the process of business rescue requires the appointed business rescue practitioners to administer the activities of the financially distressed company, such as assets.[4] Most SMEs have an insufficient number of assets to be used as security for financial assistance in an attempt to rehabilitate the entity in question.[5] In terms of section 142(3)(a)-(f) of the 2008 *Companies Act,* the business rescue practitioner is allowed to gather all assets of the financially distressed company, and to dispose of these assets to raise funds needed by the company. The unsecured assets can be disposed of as a way to raise money to settle the debts of the company in question.[6]

In the case of *EnergyDrive Systems (Pty) Ltd v Tin Can Man (Pty) Ltd,*[7] the court said that written consent from unsecured creditors is not required during the disposal of unsecured assets. However, the secured assets cannot be disposed of without the written consent of a creditor who has security over that asset.[8] The lack of sufficient assets to dispose of or use as security for the repayment of debts, contributes to business rescue being unsuccessful. Therefore, there is a strong possibility that many of the SMEs will fail from the beginning of business rescue.

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2 Elizur 2020 http://www.ventureburn.com.
3 Elizur 2020 http://www.ventureburn.com.
4 Section 141(1) of the *Companies Act* 71 of 2008.
5 Milman Governance of Distressed Firms: Corporations, Globalisation and the Law 35; Maphiri Michigan Business & Entrepreneurial Law Review 120.
6 Section 134(1)(a) of the *Companies Act* 71 of 2008.
7 2017 (3) SA 539 (GJ) para 18.
8 Section 134(3) of the *Companies Act* 71 of 2008.

Section 143(1) of the 2008 *Companies Act* entitles practitioners to receive a remuneration. These practitioners charge between R15 625-R18 750 per day for SMEs.[9] These fees are found to be expensive for most SMEs in this country. These charges are in opposition to the purpose of the method of business rescue for SMEs.[10] SMEs struggle to find financial assistance when experiencing financial distress, which means that practitioners' payments will bankrupt the companies before business rescue is concluded. Consequently, in most cases, business rescue practitioners' charges make it a challenge for business rescue to succeed in saving SMEs.

There is an informal method to restructure a company that can be followed by the company, whether in distress or not. Section 155 of the 2008 *Companies Act* makes provision for the restructuring of companies without the appointment of a business rescue practitioner. This procedure is beneficial in the sense that the enterprise saves money that was supposed to be paid to these practitioners. However, this procedure remains challenging for SMEs since there is no application of an automatic *moratorium*. The principle of automatic *moratorium* protects a company from any legal claims until the process of restructuring the company in question is complete. Therefore, the SMEs that make use of this procedure will not be protected against legal claims from their creditors.

1.2 The problem statement

1.2.1 Background to the problem

SMEs play a major role in South Africa's economic development, contributing between 20%-30% towards the country's economy.[11] These enterprises reduce unemployment by creating jobs and other business opportunities.[12] However, history shows that prior to the introduction of the 2008 *Companies Act,* over 70%

9 BVR Attorneys Inc 2021 https://bvrbusinessrescue.co.za/cost-of-business-rescue-proceedings/.
10 *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* (609/2012) [2013] ZASCA 68 (27 May 2013).
11 Ngary, Smit and Bruwer *MJSS* 911; Liedkte 2019 http://www.m.engineeringnews.co.za.
12 Ngary, Smit and Bruwer *MJSS* 911.

of South African SMEs could not survive the first five years of their existence.[13] Many factors contribute to the demise of these enterprises when they face financial distress. Moreover, section 143(6) of the 2008 *Companies Act* provides that the Minister of Trade and Industry may formulate regulations which determine how much practitioners may charge, but these fees are not affordable for most SMEs.[14]

SMEs experience challenges that reduce their growth rate regardless of their importance towards South Africa's economy.[15] Recently, the global pandemic called Covid-19 has caused a huge disruption in the world economy and South Africa's economy has not been immune to the virus. The South African government introduced measures such as relief funds to reduce the negative impact of Covid-19 on businesses; the IDC and the Department of Trade, Industry, and Competition allocated more than R3 billion to assist financially distressed companies (including SMEs).[16]

However, most applications by SMEs for Covid Business Rescue Assistance were rejected.[17] As a result, 42.7% of these enterprises closed their operations and many people lost their jobs, which increased the country's unemployment rate.[18] Therefore, the business rescue plan provided by the government still failed to save SMEs from liquidation regardless of so much money allocated. This study's aim is to determine how effective the business rescue method, as provided for in the 2008 *Companies Act*, is for SMEs.

1.3 Research question

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13 Mahembe 2011 http://www.ncr.org.za/pdfs/Literature%20Review%20on%20SME%20Access%20to%20Credit%20in%20South%20Africa_Final%20Report_NCR_Dec%202011.

14 Maphiri Business Rescue in South Africa and its Practical Application to SME's 13.

15 Mahembe 2011 http://www.ncr.org.za/pdfs/Literature%20Review%20on%20SME%20Access%20to%20Credit%20in%20South%20Africa_Final%20Report_NCR_Dec%202011.

16 Funding Connection 2020 http://www.Fundingconnection.co.za; Schindlers 2020 http://www.sapoa.org.za.

17 Smith 2020 http://www.news24.com.

18 Department of Statistics of South Africa 2020 http://statssa.gov.za; Businesstech 2020 http://www.businesstech.co.za.

Does the 2008 Companies Act make provision for effective business rescue methods for SMEs?

1.4 Aim and Objective of the study

The main aim of this research is to determine how effective the business rescue method, as provided for in the 2008 *Companies Act*, is for SMEs.

First of all, the scholar analyses how the business rescue practitioners and the administrative costs burden the SME's and prevent them from accessing formal methods of business rescue,[19] moreover, how the requirements of this formal method hinder these enterprises from accessing this method.[20] Second of all, it is argued that the requirements found in section 128 of the 2008 Companies Act do not accommodate these enterprises. Lastly, the scholar discusses how the exclusion of automatic *moratorium* in section 155 of the 2008 Companies Act exposes these enterprises to lawsuits. The objectives of the study are:

1. To determine if the exorbitant business rescue practitioners' fees hinder business rescue for SMEs.

2. Do the requirements for business rescue make the process inadequate for SMEs?

3. How could the informal business rescue process be adapted to give more protection to SMEs?

1.5 Assumption and Hypothesis

1.5.1 Assumption

This work is based on the assumption that the South African SMEs in financial distress are facing greater risk of closing down their operations because they are experience a challenge to access financial assistance and the current legal framework expose them to more financial burden and it is assumed that the

19 Section 143 of the *Companies Act* 71 of 2008.

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business rescue for SMEs in this country is not successful. Moreover, it is assumed that should this challenge continue without any intervention then many people are going to be left without jobs and the economy of this country will suffer.

1.5.2 Hypothesis

This work is based on the hypothesis that the current legal framework for business rescue methods is not accessible to SMEs. This hypothesis proceeds from the observation that the business rescue provisions of the 2008 *Companies Act* are not adequate to provide business rescue to the SMEs in South Africa due to the various access requirements which are a great challenge for such SMEs to prove and follow.

1.6 Research methodology

This study will be conducted in terms of qualitative methodology based on a literature review. The following research methods will be used:

a) Primary and secondary sources

This research analysed the relevant data in existing primary and secondary sources. The primary sources include the legislation and relevant case law. The secondary sources consist of journal articles, dissertations, theses, books, and other Internet sources relating to business rescue. The *North-West University Potchefstroom Electronic Law Journal Referencing* style was utilised for the purpose of this study.

b) Relevant legislation

The business rescue measures provided in terms of the 2008 *Companies Act* were analysed to establish whether or not they are robust enough to provide business rescue to the SMEs.

c) Relevant case law

Case law that applies to statutory business rescue measures was used to see how the method is applied in practice.

1.7 Scope of the study

Chapter one

This is an introductory chapter and presents the topic under discussion. It will set out the background to the study, the problem statement, the research question, assumption, hypothesis, aims, and objectives, the research methodology, study framework, ethics, theme, and summary of the study.

Chapter two

It is important to provide historical perspectives on aspects of judicial management concerning the period before 2008. However, this chapter will demonstrate how judicial management failed during this era and also its shortfalls. As a result, it was necessary for serious development to be undertaken in this area of law.

Chapter three

This chapter focuses on the new regime for business rescue in South Africa and illustrates the importance of business rescue, as provided for by *Companies Act* 71 of 2008, for South Africa's economy. Moreover, this chapter distinguishes between a formal and an informal method of business rescue that can be utilised by companies in financial distress. Furthermore, a discussion follows, concerning the problems encountered by financially distressed SMEs when they make use of the method of business rescue. The chapter also deals with the principle of *moratorium*.

Chapter four

Chapter four is the final chapter which will give a summary of what has been discussed in the study. It is a reasonable expectation that the recommendations and finding from the study will contribute in a meaningful way going forward, in this area of South African business law.

1.8 Conclusion

From the above, it is clear that methods of business rescue for SMEs must be taken seriously, as SMEs perform an important role in the South African economy. These methods ensure that financially distressed companies are saved from the process of liquidation. The development of business rescue concerning old regimes before 2008 will be discussed in the following chapter.

CHAPTER 2

JUDICIAL MANAGEMENT PRE 2008 COMPANIES ACT

2.1 Introduction

Judicial management is the process by which a sovereign judicial manager is appointed to handle the affairs, business, and property of a company in financial crisis, or to realise its assets in a more beneficial manner than if the company were to be wound up as part of the judicial management technique of debt restructuring.[21] However, the legislations prior to the 2008 *Companies Act* do not provide a definition of the process mentioned above. What is more interesting, is that this method was found to be a necessity in the South African legal system as it was intended to save companies in financial distress if they met the necessary requirements. The Minister of Justice,[22] provided the explanation for the adoption of this concept in South Africa, as summarised by Bangwadeen:

> The practice of judicial management has been adopted from United States of America and United Kingdom. If the company in question is found to be solvent, then a court is authorised to appoint a person who will manage this company, the purpose of the appointment of this official is to help the company from its financial distress. The judicial management can be executed in terms of the court's authority. Moreover, the Minister admitted that this concept may not be used by many countries around the world, and it has not been extensively applied in countries mentioned above, and this has to raise a concern but it will be tested in the bill before its adoption to the legislation. The application of such a concept in South Africa will be in the interest of the economy of the country, entrepreneurs, and the public in general.[23]

In light of the paragraph mentioned above, it is important to provide an outline of the improvement of the judicial management system. Before 2008 *Companies Act*

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21 Singapore Legal Advise 2022 https://singaporelegaladvice.com/law-articles/judicial-management.

22 Loubser 2013 *SA Merc LJ* 437.

23 Olver *Judicial Management in South Africa* 2-3; Bagwadeen A critical analysis of effectiveness of the business rescue regime as a mechanism for corporate rescue 17.

a method called judicial management was the only method available to rescue companies in financial distress.[24] This chapter will demonstrate the operation of judicial management and its shortfalls in this era and led to the development of judicial management as implemented in the 2008 *Companies Act*.[25]

2.2 1926 Companies Act

South Africa adopted a *Companies Bill* in 1922 which had provisions that dealt with financially stressed companies. For example, article 195 until 198 of the *Companies Bill* of 1922 provided that, if a court is approached for a remedy by a financially distressed company, the court has the authority to order the appointment of a judicial manager to reorganise the company in question.[26] In 1926 the Bill mentioned above finally became law in South Africa.[27] The 1926 *Companies Act* became the first legislation that provided for a method which deals with financially distressed companies, called judicial management.[28] Certainly, this method was new and its purpose was to save financially distressed companies.

Section 26 of the 1926 *Companies Act* provides that a company which will be eligible for judicial management (1) must prove its financial distress in terms of balance of reasonable probabilities and that the application for judicial management would save it from insolvency, and (2) granting such an order would be fair and reasonable. Even so, the 1926 *Companies Act* had no provisions specifying to what extent this judicial management should be applied, which companies were eligible for this method, especially in terms of their sizes (in terms of thresholds for turnover, the total of the fixed and current assets, and the average number of employees).[29] The requirements found in section 26 of the 1926 *Companies Act*, were only applicable to the companies registered according to section 71 of this Act, and this means that it excluded entities such as partnerships, Close Corporations, sole

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24 Bradstreet 2011 *SALJ* 353.
25 Bradstreet 2011 *SALJ* 353.
26 Olver Judicial Management in South Africa 1-2.
27 *Companies Act* 46 of 1926.
28 *Le Roux Hotel Management (Pty) Ltd and Another v E Rand (Pty) Ltd and Another* 2001 (1) All SA 223 (C) 37; Loubser 2004 *SA Merc LJ* 139.
29 Loubser 2007 *CILSA* 156.

proprietors, business trusts and cooperatives.[30] Lastly, this legislation was silent on the issues such as providing a legal protection to the company placed under judicial management until the procedure is complete.

The person to bring the application for judicial management was expected to also lodge a supplementary affidavit with the Master of the High Court of South Africa.[31] The application will be dismissed if the court is satisfied that the requirements are not met on the application.[32] However, if the court is satisfied that the requirements are met on the application, then the provisional judicial management order will be granted and the court will provide the parties with the next court date to finalise the order.[33]

Anyone could be appointed as judicial manager without providing a security or specific qualifications except the following: individuals mentally unsound, minor child, unrehabilitated insolvent.[34] The judicial management had the following duties: (a) to gather all of the company's assets and (b) to draft a report that he would use to rescue the company and present it at the meeting with all relevant stakeholders such as management and the creditors of the company in question.[35] This Act had no specific provisions to regulate the appointments and removal of the judicial managers.

Loubser argues that South Africa has been applying the method of judicial management without a solid background, since it was hardly applied in the countries from which it was derived (United Kingdom and the United States of America) and more challenges were encountered, which rendered this method less effective.[36] Therefore, this left South African courts with the responsibility to provide an assurance that the method of judicial management was properly applied. The minister's explanation mentioned above was a single explanation which provided for

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30 Lamprecht 2008 *SAJAR* 188.
31 Loubser Some Comparative Aspects Of Corporate Rescue In South African Company Law 27; Section 197 of the *Companies Act* 46 of 1926.
32 Loubser Some Comparative Aspects Of Corporate Rescue In South African Company Law 27.
33 Loubser Some Comparative Aspects Of Corporate Rescue In South African Company Law 27.
34 Loubser Some Comparative Aspects Of Corporate Rescue In South African Company Law 28.
35 Loubser Some Comparative Aspects Of Corporate Rescue In South African Company Law 28.
36 Loubser 2013 *SA Merc LJ* 438.

the adoption of judicial management as part of South African law.[37] According to Olver, it was clear from the Minister's explanation that judicial management would only be applicable under circumstances where companies can be saved from liquidation, as it is in the interest of the public and the economy of the country.[38]

In light of the paragraphs mentioned above, it has been shown that the 1926 *Companies Act* did not provide the financially distressed companies under judicial management with protection such as *moratorium* until this procedure is complete. The Act did not require the judicial managers to provide securities or specific qualifications and did not provide guidelines to be used to remove managers who failed to perform their duties. Moreover, judicial management was strictly applicable to the corporations registered according to section 71 of the 1926 *Companies Act*, and excluded entities mentioned above which fall under SMEs. Therefore, this method was not effective in the case of most SMEs.

2.3 1932 Companies Law Amendment Act

The impact of the great Depression and World War II forced governments around the world to restructure their legal frameworks to protect their economy from harm and their ways of doing business. South Africa amended its *Companies Act* 46 of 1926 (hererinafter referred to as the 1926 *Companies Act*) to *Companies Law Amendment Act* 11 of 1932 (hereinafter referred to as the 1932 *Companies Law Amendment Act*) to keep up with international corporate norms and standards, and the provisions of the previous legislation were found to be outdated. The 1926 *Compamies Act* has been silent on providing the company under judicial management with protection against any legal claim until the procedure was complete. However, the Section 196(1) of the 1932 *Companies Law Amendment Act* prohibited any legal action against a company which had been placed under judicial management, to allow the process to take place, and this means that the provisions of this section provide for the application of the principle of the

37 Olver Judicial Management in South Africa 3.
38 Olver Judicial Management in South Africa 3.

moratorium.[39] As a result, the *moratorium* was introduced into the method of judicial management and it played an important role in protecting these companies.[40]

Regrettably, the practitioners experienced problems with the application of judicial management since they were not fully qualified, which led to more problems and indebted companies.[41] However, before the courts grant the judicial management order, where there is doubt that a company is financially distressed, the courts were to determine the balance of probabilities that a company in question was ~~is~~ financially distressed and could be saved from its financial problems, and this created a challenge for the courts.[42] In 1936 the South African government appointed the Lansdown Commission to examine the 1926 Act with a view to law reform and to also evaluate new developments in corporate law.[43]

As a result, it was discovered that the provisions of the 1926 *Companies Act* dealing with judicial management were flawed in the following manner: First, the courts regularly encountered cases where there was inadequate evidence of financial distress of companies, which evidence could empower them to provide a decision on the merits of the application of judicial management, and in some cases, it was important for the initial investigation to be conducted. This was a challenge the courts were facing at that time. As a result, the Commission suggested that this application must be taken to the Master of the High Court of South Africa for a report and this would assist the court with conducting the investigation into whether the company in question did meet the requirements or not.[44]

An attempt was made to address the problem mentioned above by amending section 195 of the 1926 *Companies Act* which stipulated that each application of

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39 Rajak and Henning 1999 *SALJ* 266; Olver *Judicial Management in South Africa* 6.

40 Rajak and Henning 1999 *SALJ* 266.

41 *Le Roux Hotel Management (Pty) Ltd & Another v E Rand (PTY) Ltd (FBC Fidelity Bank Ltd (under Curatorship), Intervening)* 2001 (2) SA 727 (C) in para 55.

42 Lansdown Commission 1936 Report of Company Law Commission UG 45 para 223; Olver *Judicial Management in South Africa* 4-5.

43 Olver Judicial Management in South Africa 8.

44 Olver Judicial Management in South Africa 8; Lansdown Commission in 1936, Report of Company Law Commission UG 45 of 1936.

judicial management needed to be brought to the Master of the High Court for investigation.[45] However, the amendment of section 195 failed, because the Master was not well equipped to conduct such investigations, and the provisions of this section were not as effective as was expected.[46]

Firstly, Section 26 of the 1926 *Companies Act* provides that judicial managers must furnish the Companies Registrar with information, for example financial reports for the purpose of the judicial management. Second of all, the Commission found the provisions to be defective, which deal with the information that is required to be given to the Registrar of the Companies.

The Commission suggested that the duties of judicial managers must be widened to make provision for annual financial reports, and these reports must be provided to the Registrar of Companies annually for as long as the company in question is under administration of judicial management.[47] Therefore, the failure of judicial management was not the only reason for its failure; also the provisions of the 1926 *Companies Act* were not adequate. As a result, the 1926 *Companies Act* was placed to be amended.[48]

Section 197(B) of the 1939 *Companies Amendment Act*, provided that the judicial manager may make use of the company's money and assets to compensate the costs of the judicial management and to satisfy claims of creditors according to the law relating to liquidation.[49] In the 1926 *Companies Act* the same method was allowed. However, Olver argued that liquidating assets of the financially distressed

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45 *Companies Amendment Act* 23 of 1939; Ofwono Suggested Reasons for the failure of Judicial Management as a Business Rescue Mechanism in South African Law 2.

46 Ofwono Suggested Reasons for the failure of Judicial Management as a Business Rescue Mechanism in South African Law 2.

47 Lansdown Commission in 1936, Report of Company Law Commission UG 45 of 1936.

48 Olver Judicial Management in South Africa 9; Lansdown Commission in 1936, Report of Company Law Commission UG 45 of 1936.

49 Olver Judicial Management in South Africa 9.

company to compensate its creditors before the rescuing process is complete, does not fit the purpose of rescuing the company in question.[50]

This argument was based on the following reasons: firstly, section 197(B) of the 1939 Act mentioned above allowed the judicial managers to perform the role of liquidators and judicial managers at the same time; secondly, this hindered the accomplishment rate of the judicial management; and thirdly, it exposed many companies in financial distress to liquidation.[51] Therefore, this created a financial challenge for the financially distressed company since liquidation of its assets before judicial management is complete, does not fit the purpose of this mechanism.

The Millin Commission was established to address the need for law reform and to also evaluate new developments in corporate law in South Africa. This Commission criticised section 197(B) of the 1939 *Companies Act* by stating that selling assets of the company during the process of judicial management would defeat the purpose of judicial management.[52] As a result, the Commission recommended that the judicial manager may only sell the assets of the company in question when the court approves such a sale.

Consequently, the Commission recommended that the court must provide the Master with authority to make such an investigation to determine whether a company in question is financially distressed, and there is a likelihood for it to be rescued should the judicial management be granted.[53] It was further recommended that the judicial manager's appointment by the Master of the High Court of South Africa should be the same as in the case of liquidators or trustees, and anyone who is disqualified as a liquidator or trustee must be disqualified as a judicial manager.[54]

This means that the provisions of these sections 197(B) of the 1939 *Companies Act* and 195 of the 1926 *Companies Act* created a challenge when they were applied during the procedure of judicial management. Application of this sections raised

50 Olver Judicial Management in South Africa 9.
51 Olver Judicial Management in South Africa 9.
52 Olver Judicial Management in South Africa 9-10.
53 Olver Judicial Management in South Africa 11.
54 Olver Judicial Management in South Africa 11.

uncertainties, and amendments were required and the *Companies Amendment Act* 46 of 1952 was introduced.[55] The liquidation of a financially distressed company under judicial management was prohibited unless it was according to the court order. More cases were brought before the court in an attempt to rescue financially distressed companies in terms of the new amendment.

In *Silverman v Doornhoek Mines Ltd,*[56] the court had to deal with the competing interests of the company and the secured and unsecured creditors of the company, as the company in question was struggling financially and subsequently failed to pay its creditors. In this case, the purpose of the method in question was stated to be that it was to enable companies who found themselves in dire straits, to have sufficient breathing space so as to be more successful concerns.[57] In *Sammel and others v President Brand Gold Mining Company Limited*,[58] the facts were similar to those as in Silverman's case, and the court found the method of judicial management to be important to save companies from liquidation.

Regardless of amendments to relevant legislation, more challenges were encountered. The Millin and Lansdown commissions reported that it was best not to abolish this method.[59] The outcome of the reports indicated that it was best to keep the practice of judicial management seeing that it could still be useful in the future. However, in 1961 judicial management faced serious criticism, and it was seen as more of a liquidation procedure than a method to rescue a financially distressed company.[60]

As a result, the Master of the High Court of South Africa advised judicial management to be abolished due to its failure to succeed, and the system was seen to be abused by the application of judicial management.[61] In 1963 the Van Wyk

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55 Olver Judicial Management in South Africa 9-11.
56 1935 TPD 349.
57 *Silverman v Doornhoek Mines Ltd* 1935 TPD 349.
58 1969 (3) SA 629 (AD); Olver Judicial Management in South Africa 9-10.
59 Rajak and Henning *SALJ* 266; Lansdown Commission 1936 Report of the Company Law Commission UG 35 para 223 and the *Report of the Company Law Amendment Commission UG* 69 of 1948 at para 262; Olver Judicial Management in South Africa 9-10.
60 Levenstein An Appraisal of the New South African Business Rescue Procedure 55.
61 Loubser 2004 *SA Merc LJ* 139; Olver Judicial Management in South Africa 12.

de Vries Commission was appointed to examine the existing companies acts with aview to law reform and to also evaluate new developments in corporate law in South Africa.[62]

The Commission argued that judicial management succeeded in some cases and it would make no sense to abolish it.[63] Eventually, the Van Wyk de Vries Commission recommended that judicial management could be used to establish an appropriate mechanism to help the courts to rehabilitate financially distressed companies.[64] As a result, judicial management was not abolished and it was passed into the new legislation of 1973.[65] Section 427 and 440 of the 1973 *Companies Act* repealed sections 195 and 198 of the 1926 *Companies Act*.

2.4 1973 Companies Act

It is clear from the study above that judicial management was not abolished but re-enacted in new legislation called *Companies Act* 61 of 1973 (hereinafter referred to as the 1973 *Companies Act*). The re-enactment of judicial management in this legislation was an attempt to provide a regulatory framework to rescue companies in financial troubles by a possible way of business restructuring.[66] For example, before amendments were made, a judicial manager had been permitted to liquidate

62 Olver Judicial Management in South Africa 12; Rajak and Henning 1999 SALJ 266.
63 Olver Judicial Management in South Africa 13; Rajak and Henning 1999 *SALJ* 266.
64 Olver Judicial Management in South Africa 13. Rajak and Henning 1999 *SALJ* 266.
65 Olver Judicial Management in South Africa 13.
66 Loubser 2004 *SA Merc LJ* 137; Smits 1999 *De Jure* 85.

assets of the financially distressed company before the judicial management was complete.

These amendments prohibited such liquidation in order to protect the interests of parties involved such as the creditors of the companies in question. Section 427(1) of the 1973 *Companies Act* provides that:

(1) When a certain corporation is ill-managed - (a) cannot settle its debts; and (b) is under threat of close-down;[67]
(2) The application for Judicial Management can be brought before the court by any person affected directly or indirectly and these persons found in the section 346 and the purpose of this application must be to rescue the company which is financially distressed;[68]
(3) The court will determine if there is a likelihood that the company in question will be rescued should the judicial management application be granted.[69]

The provisions mentioned above were used to determine whether it was possible for the companies in question to settle their debts.[70] As a result, the 1973 *Companies Act* was found to be relevant and aimed at rescuing distressed companies, as it prohibited the liquidation of assets of the financially distressed company before the restructuring was complete. However, judicial management was not as successful as expected after the amendments. This was because there were other challenges besides liquidation of assets before restructuring could be completed.[71]

The judicial management procedure depended on court proceedings which made it highly expensive; as a result, it was not accessible to SMEs.[72] In *Heek and Others v Pan African Tanneries Ltd and Another,*[73] the court had to deal with issue of the

67 *Companies Act* 61 of 1973.
68 *Companies Act* 61 of 1973.
69 *Companies Act* 61 of 1973.
70 Loubser 2004 *SA Merc LJ* 141.
71 *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd Others* 2012 (3) SA 273 (GSJ) para 5.
72 Rajak and henning 1999 *SALJ* 268.
73 1951 (2) PH E20.

remuneration of the judicial managers; the court said that it is empowered to adjust the remuneration in line with recommendations by the Master of the High Court in South Africa. Moreover, section 428(2)(b) and 432(3)(b) of the 1973 *Companies Act* provided the court with a discretion to determine the payment of the judicial managers.

The Master did not follow those recommendations or take them into consideration. From this point on, it can be seen that provisions of section 428(2)(b) and 432(3)(b) of the 1973 *Companies Act* had no proper guidelines to stipulate the exact amount that judicial managers should be remunerated. Fortunately, in 1975 a meeting was held with judicial managers in the Cape Provincial Division to debate the issue mentioned above and to find a way of formulating a fixed remuneration for these managers.[74] At this meeting it was agreed upon that the judicial manager will charge R30 per hour, which may possibly be increased to R35 per hour or reduced to R25 per hour, depending on the size of the company or work to be done.[75]

The average remuneration amount to R5040,00 per month and this could be estimated to be R 16 595,04 per month in 2022. Nevertheless, the economy of South Africa in the 1970's was underperforming and this meant that these fees were expensive for financially distressed companies, considering the economic status of the country at that time.[76] These amounts shows how expensive it was for the companies in financial distress to make use of judicial management, the 1973 *Companies Act* provided no specific period that would be used in this method, and these fees applied to all companies without limitation. Therefore, these fees were imposed on SMEs in financial distress and this created a financial burden on these enterprises. It has been proven in several cases that judicial management failed to rescue large enterprises and SMEs.

In *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd*,[77] the court declared that judicial management had failed to rescue financial businesses since the date of

74 Commission of Enquiry into the Companies Act 1970.
75 Olver Judicial Management in South Africa 61-62.
76 Dolley 2003 http://www.une.edu.au/febl/EconStud/wps.htm.
77 2001 (2) SA 727 (CPD).

its adoption in South Africa. Additionally, section 427 of the 1973 *Companies Act* did not specify which type of companies were allowed to rely on judicial management in an attempt to be saved from liquidation.[78] The use of the term 'company' by the 1973 *Companies Act* was not clear and created confusion as to whether 'company' covers all the existing companies such as close corporations, public entities, and other SMEs.[79] As a result, the question was posed whether judicial management provided for by this legislation, did cater for SMEs.

2.4.1 The requirements of judicial management

The 1973 *Companies Act* contains provisions that deal with requirements to determine which application of judicial management could be brought before a court of law. Likewise, these grounds will be discussed below.

2.4.1.1 The company fails to settle its debts

The first requirement for a successful application for judicial management was that the company was not able to settle its debts and had to prove this before the court of law.[80] However, it was a challenge for SMEs in financial distress to use judicial management after proving that they could not settle their debts, as this procedure is expensive.

2.4.1.2 The likelihood that a company will be able to settle its debts if a judicial management order is granted

There must be a likelihood that when this company is placed under judicial management then it will recover financially, meaning that the company must be able to settle its debts after judicial management.[81] As has been stated above, the judicial management procedure is expensive for most SMEs, consequently the

78 Loubser Some Comparative Aspects of Corporate Rescue in South African Company Law 17.
79 Loubser Some Comparative Aspects of Corporate Rescue in South African Company Law 17.
80 Loubser Some Comparative Aspects of Corporate Rescue in South African Company Law 22.
81 Rajak and Henning 1999 *SALJ* 269.

likelihood of these entities settling their debts was slim.[82] It can therefore be argued that this requirement was to the disadvantage of SMEs.

2.4.1.3 The granting of an order for judicial management must be fair and reasonable

For the order of judicial management to be granted, the court must be satisfied that granting the order will be fair and reasonable. This caused many problems and this requirement was not suitable for SMEs, because most of these enterprises needed urgent financial assistance and more delays relating to the judicial application increased the depth of the burden of the financially distressed companies.[83] In *Rustomjee v Rustomjee (Pty) Ltd*,[84] the court had the issue of judicial management before it and the court declared that processes of judicial management regarding fees are not suitable for South African SMEs. Moreover, the court said it was not sure whether proceedings of judicial management according to the law are suitable for the small companies in South Africa.[85] Furthermore, in *Tobacco Auctions Ltd v AW Hamilton (Pvt) Ltd*,[86] the court stated that SMEs are indirectly excluded from a process of judicial management in South Africa.

This means the granting of an order for judicial management was just and reasonable to big companies but not SMEs. As matter of fact, the court said that all factors must be taken into consideration, such as the company size, its financial status, liabilities, and assets, to determine whether the application of judicial management would succeed in saving the company in question.[87]

In *Tenowitz v Tenny Investments Pty Ltd,*[88] the court stated that a reasonable probability that judicial overview would save the company from insolvency, is one

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82 Rajak and Henning 1999 *SALJ* 269.
83 Section 427(1) of *Companies Act* 61 of 1973; Loubser 2004 *SA Merc LJ* 142.
84 1960 (2) SA 753 (D) para 758; *Ronaasen and others v Ronaasen and Morgan (Pty) Ltd* 1935 CPD para 562 and 563.
85 *Rustomjee v Rustomjee (Pty) Ltd* 1960 (2) SA 753 (D) para 758; *Ronaasen and others v Ronaasen and Morgan (Pty) Ltd* 1935 CPD para 562 and 563.
86 1966 (2) SA 51 (R) para 45.
87 *Tobacco Auctions Ltd v AW Hamilton (Pvt) Ltd* 1966 (2) SA 51 (R) para 45; Loubser 2004 SA Merc LJ 149.
88 1979 2 SA 680 (E).

of the strict requirements that an applicant must meet for the order of the judicial management to be granted. Moreover, in *Porterstraat 69 (Pty) Ltd v PA Venter Worcester (Pty) Ltd,*[89] the court acknowledged that the applicant who applied for a judicial management order, must meet the requirement of reasonable probability that the company in distress will be able to settle its debts if the order is granted.

In *BOE Bank Ltd v Upbeatprops 63 (Pty) Ltd,*[90] the court dismissed the application because the applicant failed to prove to the court that if the court granted the order of judicial managent, the financially distressed company would be capable of generating money to settle its debts.

In *Le Roux Hotel Management (Pty) Ltd and Another v E Rand (Pty) Ltd and Another,*[91] it was stated that the objective of judicial management is to assist a financially distressed company from a threat of liquidation and this must be proven on a balance of probabilities. If the application is successful, a manager will be appointed to save the company.

2.4.2 The persons permitted to bring on the application for judicial management before the court

There were specific persons allowed to bring the application for an order of judicial management before the court. According to section 346 of the 1973 *Companies Act* the following persons were permitted by the law to bring the application for judicial management before the court: Firstly, shareholders and directors may decide to bring this application before the court; Secondly, all creditors of the company may approach the court to protect their future financial interests in that company; and Thirdly, the employees may approach the court to protect their employment. Therefore, the person who was permitted by law to bring this application had to have a legal relationship with the company in question.

2.5 The judicial management procedure shortfalls

89 2000 (4) SA 598 (C).
90 2001 JDR 0821.
91 2001 2 SA 727 (C).

In a practical sense, judicial management was hardly applied and it was taken as a procedure of failure.[92] Loubser argued that the procedure of judicial management was established and adopted in South Africa with a single intention, which was to rescue big companies under the impression that they were contributing more to the economy when compared with SMEs.[93] Olver strongly argued that judicial management remained limited to big companies which were understood to be more important to the economy. Olver strongly argued that judicial management remained limited to big companies which were understood to be more important to the economy.

2.5.1 The appointment of liquidators as judicial management

According to Section 429(a) of the 1973 *Companies Act,* all the property of the company concerned shall be deemed to be in the care of the Master until the provisional judicial manager is appointed and given his or her office duties.[94] Section 430 provided the judicial manager with duties to call a meeting in the company in question to request financial records, lists of liabilities and creditors, sources where money is to be raised or where it was previously raised.

The appointment of liquidators as judicial managers added to the failure of judicial management in South Africa.[95] Once the order of the judicial management is granted, the Master of the High Court will appoint these judicial managers and such appointment was not strict.[96] As a result, these managers were not required to provide qualifications to be appointed, and they performed their duties without

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92 Smith 1999 *De Jure* 85; *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd Others* 2012 (3) SA 273 (GSJ) para 5.
93 Loubser 2004 *SA Merc LJ* 149.
94 Section 429(a)(b)(i)-(ii) of the *Companies Act* 61 of 1973.
95 Loubser 2004 *SA Merc LJ* 149.
96 Loubser 2004 *SA Merc LJ* 149.

furnishing securities. This means that if they committed misconduct they could not be held liable, and also there was no formal procedure to appoint these officials.[97]

2.5.2 The massive confidence placed in courts including its financial impact on SMEs

SMEs could not afford judicial management since this process relies most on their confidence in expensive court proceedings.[98] Likewise, the administration costs of courts are expensive since there are possible delays due to various circumstances. The special decision has to be passed for the corporation to bring application of judicial management except if ordinary resolution would be enough. What is more, if SMEs are placed under judicial management, it means that they will be exposed to disadvantages, since the costs of court proceedings are too steep for these enterprises.

Consequently, this situation does not serve the purpose of judicial management since the intention of this procedure is to save the financially distressed company, not to indebt it further.[99] Nevertheless, maybe judicial management was not the actual problem to SMEs; on the other hand, maybe the problem was caused by relying too much on court proceedings which were burdensome to these enterprises. Therefore, placing confidence in court proceedings was a failed procedure for saving SMEs.

2.5.3 Judicial management is not the most important method

Most courts in South Africa saw judicial management as a strange method, not as a practical mechanism to prevent companies from being liquidated.[100] This procedure was supposed to be given first preference and be treated as an important, which makes it difficult to avoid when a financially distressed company seeks debt relief. What is strange, is that creditors were permitted to liquidate a company, if

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97 Loubser 2004 *SA Merc LJ* 149.
98 Loubser 2004 *SA Merc LJ* 155.
99 Rajak and Henning 1999 *SALJ* 268.
100 Mahembe 2011 http://www.ncr.org.za/pdfs/Literature%20Review%20on%20SME%20Access%20to%20Credit%20in%20South%20Africa_Final%20Report_NCR_Dec%202011.

they did not receive the amount that was due to them, and they did all of this without considering judicial management first.[101] Above all, SMEs in terms of their size, require a simple procedure in order to be successfully saved. Therefore, judicial management was also a procedure that was too complex to be used by SMEs.

2.5.4 The company must be in financial distress for the court to grant a judicial management

The court must be satisfied that the company is in financial distress before granting the order of judicial management.[102] Certainly, this requirement contributes to the failure of this procedure. It will be reasonable for this requirement to be omitted and judicial management to be granted immediately, when dealing with SMEs. Moreover, Klopper argued that the sooner the financially distressed company is granted an order of judicial management, the greater the likelihood of business rescue succeeding.[103] Therefore, SMEs deserve to be awarded judicial management immediately when they bring their application before the court so that they can be saved immediately.

2.5.5 The court order to cancel a judicial management contract

The courts had the authority to cancel the judicial management contract, and no other person was allowed to bring such contract to an end. However, Loubser argued that since the court is the only entity with authority to cancel the judicial management contract, this gave the appointed manager room to relax rather than to perform his or her duties in time; and it means more delays will lead to unnecessary expenditure.[104]

2.6 Other alternative methods

The company and its creditors were allowed to make arrangements outside of court. For example, section 311 and 389 of the 1973 *Companies Act* affords the creditors

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101 Museta The Development of Business Rescue in South African 16.
102 Burdette 2004 *SA Merc LJ* 349.
103 Kloppers 1999 *Stell LR* 429.
104 Loubser Some Comparative Aspects of Corporate Rescue in South African Company Law 41.

of the company an opportunity to play a part in the process of rescuing a company in question; in this case, the company and its creditors were allowed to make agreements with each other in attempt to protect their respective interests. During this process *moratorium* to prevent further financial harm to the company concerned. Rajak argued that this method is much preferable for use by companies with their creditors since it is simple and user friendly.[105] Also, Smith argued that this procedure is accommodative towards both parties as in the end both parties' interests are protected.[106]

This process is beneficial for both parties and fewer funds are required to facilitate it. However, Burdette submitted that the process of renegotiation by the ailing company with its creditors is expensive and was not as effective in practice as it was believed to be.[107] In addition, Kloppers submitted that section 311 of the 1973 *Companies Act* does not cater to creditors and employees of the company in question. In light of the above, it is difficult to find out if section 311 of the 1973 *Companies Act* could be suitable to rescue SMEs. Section 311 was not used to rescue SMEs which were promising to contribute to the economy and eradicate poverty. Furthermore, challenges associated with sections 311 and 389 of the 1973 *Companies Act* will be discussed below.

To start with, the claim that section 311 of the 1973 *Companies Act* is a simple method that affords the distressed company an opportunity to approach its creditors to renegotiate their legal obligations, can be defined from the perspective of SMEs.[108] The method provided for in this section was complicated and costly for SMEs because this process took place in the form of meetings, and the report had to be compiled and submitted before the court of law.[109]

Moreover, additional costs were incurred for the following: publication in a newspaper, unreasonable consultation fees, and chairmen of the meeting who

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105 Rajak Insolvency Law Theory and Practice: *The Economic Implications of Attemptingto Rescue Companies* 309-311.
106 Smith 1999 *De Jure* 86.
107 Burdette 1999 *De Jure* 44-58.
108 Klopper and Bradstreet 2014 *Stell LR* 555.
109 Klopper and Bradstreet 2014 *Stell LR* 555.

requested unreasonable remuneration.[110] Furthermore, this section imposed more burdens on financially distressed SMEs and was not effective for these enterprises. Lastly, the application of measures contained in section 389 of the 1973 *Companies Act* was used as a shortcut between creditors and companies, and the provisions of this section had no good intention to save the ailing company.

2.7 Conclusion

SMEs were not acknowledged as juristic persons by the 1973 *Companies Act,* and this undermined the role that these companies performed in the economic development in South Africa. Consequently, all methods provided by this legal framework to rescue financially distressed companies were not accommodative to SMEs.[111] Moreover, South Africa's legal system was ignorant in acknowledging the need of developing a new legal regime or instituting reasonable methods that would accommodate SMEs.[112] Rajak and Henning submitted that the South African legal system which deals with business rescue must be amended in such a way that it accommodates all businesses of different sizes and nature, and that will assist South Africa to level up with the standards of the global economy.[113]

The list of the legislations mentioned above did not cater for other entities except those registered under them, and this was wrong as most SMEs, such as Close Corporations, were not registered under these Acts. Consequently, judicial management was not available to SMEs and thereby renderd this method ineffective, as it was only used for those entities registered in terms of these legislations. The development of business rescue concerning the new regime after 2008 in South Africa will be discussed in the following chapter.

110 Klopper and Bradstreet 2014 *Stell LR* 555.
111 Rajak and Henning 1999 *SALJ* 269.
112 Rajak and Henning 1999 *SALJ* 269.
113 Rajak and Henning 1999 *SALJ* 269.

CHAPTER 3

BUSINESS RESCUE UNDER *COMPANIES ACT* 71 OF 2008

3.1 Introduction

This chapter focuses on the new regime for business rescue in South Africa and illustrates the importance of business rescue, as provided for by the *Companies Act,*[114] for the economy of South Africa. Furthermore, problems encountered by financially distressed SMEs when they make use of both formal and informal methods of business rescue, are discussed. The chapter also deals with the *moratorium*.

Section 128(1) (b) of the *Companies Act*,[115] defines business rescue as a method that is used to rehabilitate financially distressed companies under the short-term supervision of business rescue practitioners who formulate a business rescue plan that will be used to revive the company in question.[116] History has shown that financially distressed SMEs are under serious threat of extinction.[117] However, the

114 Section 128 of the *Companies Act* 71 of 2008.
115 *Companies Act* 71 of 2008.
116 Section 128(1) (d) of the *Companies Act* 71 of 2008.
117 Mahembe 2011

method of business rescue offers financially distressed SMEs a chance to restructure themselves under the guidance of business rescue practitioners, who must introduce plans which can assist to improve the financial status of the SMEs.

The successful implementation of a sound business rescue plan extends the existence of financially distressed SMEs in question, secures the interests of the relevant parties. On the other hand, if the plan introduced fails, the reality will be that the financially distressed SMEs will shutdown and all relevant parties will lose their interest.[118] Consequently, the success of a business rescue plan for SMEs is important.[119]

3.2 Requirements for business rescue application

The application for business rescue can be brought in terms of section 129 of the *Companies Act.*[120] For example, section 129(1)(a) and (b) of the *Companies Act*,[121] provides that a voluntary application for business rescue may be brought by the board of officials of the company after reaching the resolution that the company must be placed under business rescue and there is likeliness that it will be saved. Moreover, section 129(1)(a) of the *Companies Act*,[122] provides that any other affected person such as an employee, a shareholder, a union, a director, or a creditor may apply to the court for a business rescue order. If the court grants the order, the financially distressed company will be placed under the temporary supervision of a business rescue practitioner.[123] For these applications to be successful the following requirements must be met:

3.2.1 The company must be financially distressed

http://www.ncr.org.za/pdfs/Literature%20Review%20on%20SME%20Access%20to%20Credit%20in%20South%20Africa_Final%20Report_NCR_Dec%202011.

118 Cassim *et al Contemporary Company Law* 537; Klopper and Bradstreet 2014 *Stell LR* 554.

119 Klopper and Bradstreet 2014 *Stell LR* 554.

120 *Companies Act* 71 of 2008.

121 *Companies Act* 71 of 2008.

122 *Companies Act* 71 of 2008.

123 Sharrock, Smith and van der Linde *Hockley's Insolvency Law* 277; section 128(1)(i) and section 131 of the *Companies Act* 71 of 2008.

Financial distress can be defined as a financial problem that leads to failure by a company to pay debts in the future.[124] According to this definition, attention is given to the future financial status of the company, rather than the current financial status.[125] Before the company can be placed under the method of business rescue, the court must be satisfied that the company is indeed in financial distress.[126] For example, section 128(1)(f) of the *Companies Act*,[127] provides that the company will be considered to be financially distressed once it is found that within six months of the date of application, the company will fail to meet its legal obligations such as paying its debts or will possibly be declared insolvent.

This becomes a critical period where a method of business rescue is needed for these companies found to be within the principles of the *Companies Act* 71 of 2008. This includes SMEs and companies which were founded before the promulgation of this Act, for example close corporations, which can rely on section 66(1) of *Close Corporation Act*,[128] to apply for this method. It has been indicated above that SMEs are under threat of extinction within five years of their establishment.[129] Hence, financially distressed SMEs deserve immediate application for business rescue.

Loubser recommends the expansion of the definition of "financial distress" to take into account all circumstances which may lead a company to be declared insolvent. This will permit the affected individual to make application to save the said company.[130] Consequently, this recommendation affords SMEs which have a chance to apply for business rescue, to do so as soon as possible.[131] Moreover, due to the

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124 Section 128 of the *Companies Act* 71 of 2008.
125 Section 128 of the *Companies Act* 71 of 2008.
126 Levenstein and Barnett 2013 http://www.werksmans.com/wp-content/uploads/2013/04/Werksmans-Basics-of-Business-Rescue1.pdf.
127 *Companies Act* 71 of 2008.
128 *Close Corporations Act* 69 of 1984.
129 Mahembe 2011 http://www.ncr.org.za/pdfs/Literature%20Review%20on%20SME%20Access%20to%20Credit%20in%20South%20Africa_Final%20Report_NCR_Dec%202011.
130 Loubser Some Comparative Aspects of Corporate Rescue in South African Company Law 44.
131 Mahembe 2011 http://www.ncr.org.za/pdfs/Literature%20Review%20on%20SME%20Access%20to%20Credit%20in%20South%20Africa_Final%20Report_NCR_Dec%202011.

financial nature of SMEs, they must be allowed to resort to business rescue as soon as possible if they experience some type of financial distress.[132]

This recommendation advocates that the period of six months stipulated in section 128(1)(f) of the 2008 *Companies Act* has to be applied only to bigger companies, while SMEs are afforded an exception for their survival. Rajak and Henning recommended that South Africa should consider a dual-system approach when it comes to business rescue; one approach has to be for large enterprises and the other approach has to be for SMEs.[133] Moreover, these scholars recommended that business rescue for SMEs must follow a flexible approach to promote the effectiveness and success of these enterprises.[134]

Loubser indicates that a financially distressed company must be permitted to apply for business rescue as soon as possible, without having to prove that they will most likely not be able to pay debts or be declared insolvent in six months.[135] Moreover, it is clear that for the method of business rescue to be successful, SMEs must be allowed to resort to this method within a reasonable time.[136] However, section 128(1) (f) of the 2008 *Companies Act* requires these enterprises to be actually financially distressed in order to apply for business rescue; therefore, these enterprises will not be able to apply for business rescue even if there is a reasonable possibility that they are about to be financially distressed.

As a result, these enterprises would not receive any protection via business rescue against their creditors' demands.[137] For instance, when the business operations of SMEs are affected by factors such as an employee strike, it means that they are experiencing financial loss and these enterprises would not be able to apply for this method until they are declared financially distressed. Loubser further recommended that when the board of directors of a company finds that there is a likelihood that their company will be financially distressed in six months' time, they may apply to

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132 Loubser Some Comparative Aspects of Corporate Rescue in South African Company Law 57.
133 Rajak and Henning 1999 *SALJ* 268.
134 Rajak and Henning 1999 *SALJ* 268.
135 Loubser Some Comparative Aspects of Corporate Rescue in South African Company Law 57.
136 McCormack Corporate Rescue Law – An Anglo American Perspective 9.
137 *Companies Act* 71 of 2008.

the court for a business rescue order while there is still time.[138] The approval of this recommendation will contribute positively to the success of this method for SMEs in South Africa.[139]

3.2.2 The company must be in a position to be rescued

The 1973 *Companies Act* provides the court with wide discretion to determine whether a company can be rescued or not, but the 2008 *Companies Act* provides a more restricted discretion on this matter.[140] For example, section 129(1) (b) of the 2008 *Companies Act* provides that the company's representative must reasonably believe that the company could be rescued if placed under business rescue. Loubser argued the use of the term 'prospect' is confusing and should be replaced with a term such as 'possibility' to prevent confusion during interpretation of the section in the future.[141] It is clear that if the current term was substituted by the term 'possibility' it was going to be easier for an SMEs directors to apply for business rescue, and such terms will contribute to making this provision effective for business rescue.

3.3 People who are allowed to bring the application for business rescue

The application for business rescue can be brought before court by specific individuals and all of these persons must have a legal relationship with financially distressed company.

3.3.1 The authority to institute an application for business rescue

Chapter six of the 2008 *Companies Act* has a broad approach towards business rescue. For example, the directors of the company may reach a resolution and file with the Companies and Intellectual Property Commission, which will initiate this procedure of business rescue without applying directly to court.[142] Any affected individual such as employees, shareholders, registered trade unions, and creditors

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138 Loubser Some Comparative Aspects of Corporate Rescue in South African Company Law 57.
139 Loubser Some Comparative Aspects of Corporate Rescue in South African Company Law 57.
140 Loubser Some Comparative Aspects of Corporate Rescue in South African Company Law 57.
141 Loubser Some Comparative Aspects of Corporate Rescue in South African Company Law 58.
142 Section 129 (1) and (3) of the *Companies Act* 71 of 2008.

can also approach the court for a business rescue order.[143] Musetta suggested that some companies will take advantage of this and abuse it.[144] In *Swart v Beagles Run Investments 25 (Pty) Ltd and Others*,[145] the court held that the applicant used business rescue to avoid making debt payments to the respondent and this action constituted an abuse of this procedure.

Moreover, in *ABSA Bank Ltd v Newcity Group (Pty) Ltd*,[146] the court found that the purpose of the application for business rescue brought by the applicant was to abuse and manipulate the procedure of business rescue. On the other hand, one could say that this regime gives individuals like employees a chance to apply for business rescue for SMEs which they are working for because it ensures job security if the SMEs are rescued. However, it is difficult for employees to apply for a business rescue order because they would have to prove that the company is in financial distress and can be rescued, but they may not have access to the financial records of the company.

3.4 Business rescue shortfalls

3.4.1 Limitation on entities to which business rescue applies

Regulation 127(2)(b) of the *Companies Regulation* of 2011 limits application for business rescue to small, medium, and big companies, and this regulation is assumed to be serving the public interest. Likewise, these regulations extend to classifications of business rescue practitioners in terms of company size and this size is determined by the annual income of the company.[147] Also, the remuneration of these practitioners depends on the size of these companies.[148] This is supposed to be good news since SMEs would appoint suitable business rescue practitioners, but these individuals are still expensive, which pushes these enterprises into more financial distress.[149] The business rescue practitioners' remuneration, as stipulated

143 Section 128(1) (a) of the *Companies Act* 71 of 2008.
144 Museta The Development of Business Rescue in South African Law 66.
145 2011 5 SA 422 (GNP).
146 2012 ZAGPJHC 144 (GSJ).
147 Regulation 127 (2) (c) of the *Companies Regulation* of 2011.
148 Regulation 127 (2) (c) of the *Companies Regulation* of 2011.
149 Mahembe 2011

in the Companies Regulations, is often unaffordable for SMEs which are already in financial distress.[150]

3.4.2 Financial assistance for SMEs

Financial assistance can be defined as a direct or indirect method that a financially distressed company can apply to generate funds, such as offering securities like shares or taking a financial loan.[151] This is a valuable feature of business rescue and it serves as the core of this method.[152] These financially distressed companies can receive financial assistance from financial providers such as banks, creditors, and other financiers.[153] However, most financial providers hardly provide financial assistance to the companies under the process of business rescue since it is not a wise business decision to do so or is extremely risky.[154]

Most of the SMEs lack assets, which makes it impossible for financial providers to provide financial assistance.[155] Consequently, most of these enterprises do not have access to financial assistance. These enterprises are then often personally funded for their operations to continue.[156] The legal obligation for payment of the loan exists between the financial institutions and the individual in his or her personal capacity, and the enterprise.[157]

Unfortunately, some SMEs then require more money in order to be rescued, which can be more than their net worth and this decreases the chances of being rescued. Eventually, the success of business rescue of these enterprises depends on the likelihood of obtaining funds with a massive risk before the enterprises. Pretorius

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http://www.ncr.org.za/pdfs/Literature%20Review%20on%20SME%20Access%20to%20Credit%20in%20South%20Africa_Final%20Report_NCR_Dec%202011.

150 Milman 2013 Governance of Distressed Firms: Corporations, Globalisation and the Law 36.

151 Section 44, 45 and 135 of the *Companies Act* 71 of 2008.

152 Cassim *et al Contemporary Company Law* 882.

153 Cassim *et al Contemporary Company Law* 822.

154 Cassim *et al Contemporary Company Law* 822.

155 Mahembe 2011 http://www.ncr.org.za/pdfs/Literature%20Review%20on%20SME%20Access%20to%20Credit%20in%20South%20Africa_Final%20Report_NCR_Dec%202011.

156 Mahembe 2011 http://www.ncr.org.za/pdfs/Literature%20Review%20on%20SME%20Access%20to%20Credit%20in%20South%20Africa_Final%20Report_NCR_Dec%202011.

157 Milman 2013 Governance of Distressed Firms: Corporations, Globalisation and the Law 36.

and Du Preez submit that there is a lack of access to financial assistance in South Africa.[158] Therefore, this submission leaves SMEs stranded since this type of funding may contribute to the success of business rescue for these enterprises.[159]

SMEs are sensitive and need strong legal protection, and Pretorious and Du Preez recommend that 2008 *Companies Act* must restrict the business rescue practitioners to be those with enough experience but must be familiar with these SMEs to prevent complications.[160] Moreover, both Pretorius and Du Preez suggested that senior business rescue practitioners can use their knowledge, skills, and their networks to secure the funding.[161] However, there is going to be a problem when it comes to remunerating these practitioners, since SMEs are known to have a lack of assets and money.

3.5 Business rescue benefits for SMEs

3.5.1 Protection against creditors' demands

Financially distressed SMEs who are under the process of business rescue receive a benefit like a *moratorium* against their creditors' demands until this process is complete.[162] Moreover, the *moratorium* protects these enterprises from anyone who may have a claim against them especially their creditors and protects the lawful assets in possession of this company.[163] This principle was found to be effective for financially distressed SMEs. Thus section 133(1) of the 2008 *Companies Act* also prevents courts and business rescue practitioners from entertaining the actions of creditors of financially distressed SMEs.

It is understandable that when business rescue practitioners initiate an investigation of financially distressed SMEs, then a business rescue plan must be established right away. As a result, the protection that comes with the principle of the *moratorium* will be applicable, and the assets of these enterprises will be protected until the

158 Pretorius and Du Preez 2013 *SAJESBM* 174.
159 Pretorius and Du Preez 2013 *SAJESBM* 174.
160 Pretorius and Du Preez 2013 *SAJESBM* 174.
161 Pretorius and Du Preez 2013 *SAJESBM* 174.
162 Section 133(1) of the *Companies Act* 71 of 2008.
163 Section 133(1) of the *Companies Act* 71 of 2008.

process of business rescue is complete or until the financial assistance is secured to pay their creditors.

3.5.2 The employees' rights

Chapter six of the 2008 *Companies Act* affords employees of financially distressed SMEs a right to equality when it comes to initiating the process of business rescue.[164] What is more, special preference is given to the salaries of the employees of the financially distressed enterprises.[165] Section 135(1) of the 2008 *Companies Act* enables the employees to receive their payment despite the ongoing process of business rescue.[166]

Despite all of that, the salaries of the employees are determined after the costs of business rescue practitioners and the process of business rescue have been determined, and this takes place before a claim such as financial assistance.[167] The process of business rescue gives the employees of financially distressed SMEs a right to protect their jobs, and this also contributes to the development of these enterprises which will create more jobs.

In *Employees of Solar Spectrum Trading 83 (Pty) Limited v AFGRI Operations Limited*,[168] the court had to deal with the application for business rescue initiated by the employees of the financially distressed company, and the court had to balance the competing interests of the employees and the creditors of the company in question. The court provided that the employees have less access to the documents which can provide a clear financial performance and position of the company in question compared to its shareholders.[169] The court found that the employees may provide useful information about the history and challenges that this company has experienced over time, and may provide solutions that may assist

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164 Cassim *et al Contemporary Company Law* 844.
165 Section 136 (1) of the *Companies Act* 71 of 2008.
166 Loubser Some Comparative Aspects of Corporate Rescue in South African Company Law 47.
167 Loubser Some Comparative Aspects of Corporate Rescue in South African Company Law 47.
168 (unreported) case number (6418/2011, 18624/2011, 66226/2011,66226A/11) (08 August 2012).
169 *Employees of Solar Spectrum Trading 83 (Pty) Limited v AFGRI Operations Limited* (unreported) case number (6418/2011, 18624/2011, 66226/2011, 66226A/11) (08 May 2012) para 18.

business rescue practitioners when formulating a plan to rescue the company in question.[170]

In *Employees Solar Spectrum Trading 83 (Pty) Limited*,[171] the court referred to the following cases *Anglo Irish Bank Corporation Ltd v West City Precinct Properties (Pty) Ltd and Another,*[172] *Zoneska Investments (Pty) Ltd/Bonatla Properties (Pty) Ltd v Midnight Storm Investments 386 Ltd,*[173] and declared that the creditors of the company in the process of business rescue are obliged to act reasonably or act in bona fide during the formulation of the business rescue plan.[174]

The decision in *Employees of Solar Spectrum Trading 83 (Pty) Limited*,[175] was followed in *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd*,[176] where the court declared that the creditors are obliged to adopt a positive attitude to the business rescue practitioners and the plans which they propose to rescue the company in financial distress. Therefore, the creditors will not be allowed to oppose the business rescue plan once the procedure of rescuing the company in question has already started, especially when they are not acting in good faith.[177]

The distinction can easily be drawn between the employees of the financially distressed enterprise placed under the process of business rescue versus the employees of a liquidated enterprise. The benefit lies with employees whose enterprise is under business rescue, not the liquidated enterprise. What is more is that when these enterprises are liquidated according to section 38(1) of the

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170 *Employees of Solar Spectrum Trading 83 (Pty) Limited v AFGRI Operations Limited* (unreported) case number (6418/2011, 18624/2011, 66226/2011, 66226A/11) (08 May 2012) para 18.

171 *Employees of Solar Spectrum Trading 83 (Pty) Limited v AFGRI Operations Limited* (unreported) case number (6418/2011, 18624/2011, 66226/2011, 66226A/11) (08 May 2012) para 37.

172 (unreported) case number (19075/11, 15584/11) [2012] ZAWHC 33 (18 April 2012) para 22.

173 (unreported) case number (9831/2011,7811/2012) [2012] ZAWCHC 163 (22 August 2012) para 67.

174 *Employees of Solar Spectrum Trading 83 (Pty) Limited v AFGRI Operations Limited* (unreported) case number (6418/2011, 18624/2011, 66226/2011, 66226A/11) (08 May 2012) para 37.

175 *Employees of Solar Spectrum Trading 83 (Pty) Limited v AFGRI Operations Limited* (unreported) case number (6418/2011, 18624/2011, 66226/2011, 66226A/11) (08 May 2012) para 37.

176 2013 (4) SA 539 (SCA) para 17.

177 *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* 2013 (4) SA 539 (SCA) para 38.

Insolvency Act,[178] the employer of the liquidated company has a right to terminate all employment contracts, starting from the date of liquidation.[179] Likewise, once these contracts are terminated then the services of the employees are no longer needed and remuneration is no longer paid to these employees. In addition, the termination of these contracts does not take place right away but the contracts still last for 45 days after the liquidation is finalised, unless the employees have agreed with the liquidator to continue to render their services.[180] Consequently, this allows the employees to receive salaries before the company shuts down its business operations.

3.5.3 Protection of breach of contracts

It is clear from the study above that section 136(2) and 136 (2A) of the 2008 *Companies Act* provides business rescue practitioners with the authority to terminate the contracts of employees of the SMEs, and these employees cannot bring an action for breach of contracts against these enterprises as the process of business rescue is in motion. Likewise, the claim for breach of contract employment and other contracts against SMEs will be applicable after the process of business rescue has taken place.[181] Moreover, the practitioner has the authority to institute a pressing application to the court to terminate or suspend other contracts that these enterprises are found to have undertaken.[182] This authority given to the business rescue practitioner operates the same way as the principle of the *moratorium*.

This authority to cancel the contractual obligations allows the practitioner to investigate how these enterprises became financially distressed in the first place. Once the practitioner has found the source of financial distress to the enterprise in question then a rescue can take place. However, when business rescue practitioners exercise the authority given to them, they must not exceed the scope of the

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178 *Insolvency Act* 24 of 1936.
179 Section 38(1) of the *Insolvency Act* 24 of 1936.
180 Section 38(1) of the *Insolvency Act* 24 of 1936.
181 Cassim *et al Contemporary Company Law* 886.
182 Section 136(2) (b) and 136(2A) (a) of the *Companies Act* 71 of 2008.

authority vested in them as that may threaten the success of the financially distressed enterprise. For instance, if these practitioners abuse the authority given to them by terminating other (commercial) contracts, then the possibility for these parties to contract again becomes reduced and other parties would not want to do business with an enterprise that cannot honour its legal obligation. Therefore, the principle of *moratorium* allows the business rescue practitioners to pay attention to saving the company from its financial troubles by protecting a company against any legal action.[183]

3.6 The business rescue practitioner

The business rescue practitioner is a licensed official who must be appointed by a court during the business rescue process, and he or she must report to the court about progress with rescuing the financially distressed company.[184] For a financially distressed company to be placed under the process of business rescue, a business rescue practitioner must be appointed, and this individual will draft and implement a business rescue plan to rescue the company in question.[185] In *ABSA Bank Limited v Du Toit and Others*,[186] the court acknowledged that once a financially distressed company is placed under business rescue, the business rescue practitioner who is appointed, is expected to draft and implement a business rescue plan. Therefore, financially distressed SMEs that would like to make use of the process of business rescue will have to apply for a business rescue order, and when this order is granted the court will appoint this official.

3.6.1 The business rescue practitioner's appointment

For an official to be appointed as a business rescue practitioner, he or she must meet the requirements set out in 2008 *Companies Act*. For example, section 138(1) of the 2008 *Companies Act* provides that this official must be lawful, a business

183 Klopper and Bradstreet 2014 *Stell LR* 562.
184 Section 128(1) (d) of the *Companies Act* 71 of 2008.
185 Section 128(1) (d) of the *Companies Act* 71 of 2008.
186 (7311/13) [2013] ZAWCHC 194 para 1-2; *New Port Finance Company (Pty) & Another v Nedbank Limited* 2016 (5) SA 503 (SCA).

manager in good standing, or have a good recording of accounting.[187] As mentioned earlier on, it will serve the interests of the economy, employees, and SMEs to appoint practitioners who have experience and skills for these enterprises.[188] In this case, it means the appointed practitioner must have experience and be the expert when it comes to these enterprises, as the practitioners have authority to delegate their duties to the agents of the enterprise such as a director or a manager or to appoint any individual who possesses the same skills and experience.[189] As a result, the delegation exercised by the appointed practitioner will bring more financial burden to these enterprises.

3.6.2 The business rescue practitioner authority

The other problem that SMEs are facing, is that a great number of practitioners appointed to rescue these enterprises are hardly receiving regulation from 2008 *Companies Act*. Consequently, this leaves room for abuse of business rescue since this individual has total control of the financially distressed company's management.[190] Likewise, section 140 (1)(a)(b) of the 2008 *Companies Act* provides that the business rescue practitioner has authority to delegate his authority to any former member of the board or the current management of the financially distressed company, and also has authority to remove that official from their respective office in the company in question.

It is even more significant that the presence of the management of the financially distressed company has less impact, since total control of the company is given to the business rescue planner.[191] The management of the financially distressed company tends to lose interest in working towards rescuing the company in question since total control is given to business rescue practitioners.[192] The scope of authority given to these practitioners possesses a potential threat to the success of business

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187 Section 138(1) of the *Companies Act* 71 of 2008.
188 Mahembe 2011 http://www.ncr.org.za/pdfs/Literature%20Review%20on%20SME%20Access%20to%20Credit%20in%20South%20Africa_Final%20Report_NCR_Dec%202011.
189 Section 140(1) (b) (c) (ii) of the *Companies Act* 71 of 2008.
190 Bradstreet 2010 *SA Merc LJ* 199.
191 Section 140 (1)(a)(b) of the *Companies Act* 71 of 2008.
192 Section 140 (1)(a)(b) of the *Companies Act* 71 of 2008.

rescue for SMEs, since these practitioners are allowed to remove the management of the company in question, whose managers have more knowledge and experience in that enterprise.

3.6.3 The business rescue practitioner's remuneration

Section 143 of the 2008 *Companies Act* provides that business rescue practitioners are entitled to remuneration for rendering their services in terms of the *Companies Regulations* of 2011. The remunerations provided by these regulations are expensive for a great number of SMEs. For example, the practitioners charge the small enterprises an amount of R 15 625 per day, which can be broken down into R 1 250 per hour, and medium enterprises are charged R 18 750 per day, which can be broken down into R 1 500 per hour of their services.[193] Therefore, these charges are found to be expensive and can ruin the chances of these enterprises ever from overcoming their financial distress, since it is more common that these enterprises may not make good profits while under the process of business rescue.

consequently, the expensive fees of practitioners result in the company not having any money left to run the business. Moreover, the 2008 *Companies Act* does not prevent these practitioners from requesting additional charges.[194] Likewise, this allows these practitioners room to request more charges besides the charges prescribed by this legislation; in the end, the SMEs cannot access the process of business rescue.

3.7 Section 115 of the Companies Act 71 of 2008

The financially distressed company may be rescued by alternative methods than the process of business rescue. There are other provisions of 2008 *Companies Act* whereby the financially distressed company and its creditors may renegotiate their current terms in order to rescue the company. For example, section 155 of the 2008 *Companies Act* provides that the financially distressed company and its creditors may compromise their previous terms with new terms to reduce the financial burden

193 Regulation 128 of the *Companies regulations* of 2011; Bierman 2021 businesspartners.co.za.
194 Section 143(2) (4) of the *Companies Act* 71 of 2008.

on the company in question.[195] SMEs may resort to this alternative method to overcome their financial burden instead of making use of business rescue. SMEs which are already under the process of business rescue cannot use this alternative method.[196] When a SME enters into a method of compromise with its creditors to renegotiate their previous arrangement, both parties are bound to the new/(renegotiated) agreement.[197] In *Tuning Fork (Pty) Ltd t/a Balanced Audio v Greeff* and Another,[198] the court held that the compromising agreement does not take away the liability of the financially distressed company to its creditors. Therefore, this method protects the interests of all parties involved in the agreement.

3.7.1 The advantages of section 155 of Companies Act 71 of 2008

3.7.1.1 The company does not need to be financially distressed

Section 155(1) of the 2008 *Companies Act* provides that enterprises may make use of this section whether they are financially distressed or not. This process will be effective for SMEs when they start to experience financial problems, especially if they cannot afford to pay their creditors anymore. Likewise, allowing SMEs to make use of the section mentioned above, will assist these enterprises to overcome their financial problems.[199]

3.7.1.2 The appointment of a business rescue practitioner is not required

The process of compromising does not require the creditors and the company to make use of business rescue practitioners, who formulate an investigation about the dealings of the company in question and later formulate a restructuring plan to rescue it.[200] The SMEs that rely on the method provided in section 155 of 2008 *Companies Act* must formulate a plan which will improve their financial problems.

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195 Cassim *et al Contemporary Company Law* 909.
196 Section 155 of the *Companies Act* 71 of 2008.
197 Cassim *et al Contemporary Company Law* 910.
198 2014 (3) SA 500 (WCC).
199 Mahembe 2011 http://www.ncr.org.za/pdfs/Literature%20Review%20on%20SME%20Access%20to%20Credit%20in%20South%20Africa_Final%20Report_NCR_Dec%202011.
200 Klopper and Bradstreet 2014 *Stell LR* 558.

Consequently, SMEs which make use of the method of compromise gain revenue, and the board members of these enterprises who are part of this process are gaining the skills and experience. The restructuring plan formulated by the company will be considered in the meeting of its creditors where it can be accepted or disapproved.[201] Since the section mentioned above makes it possible for these enterprises and their creditors to restructure in absence of the business rescue practitioner, it means that these enterprises will save money.[202] It was found in most cases that the profit generated by these SMEs while under the process of business rescue is not enough to settle the fees of the business rescue practitioner. Therefore, the method to compromise has been shown to be beneficial to the SMEs with cost reduction, as a business rescue practitioner is not needed to formulate the plan of restructuring.

3.7.1.3 There are no administration fees to be paid

The company's board or its liquidator has the authority can send a new arrangement to the company's creditors individually or as a group. This means that the copy of this arrangement will be sent to all creditors who are known to the company and this copy contains a notice of a meeting that the creditors have to consider.[203] The compromise method will permit the SMEs to formulate their restructuring plan and to organise a meeting with their creditors whether they are financially distressed or not. The costs of this process are considered to be affordable compared to the costs of business rescue and the process will only be binding in terms of the court order.

3.7.2 The disadvantage of section 155 of Companies Act 71 of 2008

There is no compulsory *moratorium* applicable when the company makes use of the method to compromise with its creditors.[204] Consequently, affected creditors may bring an application to the court for the company in question to be placed under business rescue, and the negotiation between the company and its other creditors

201 Klopper and Bradstreet 2014 *Stell LR* 558.
202 Regulation 128 of *Companies Regulations* of 2011.
203 Section 155(2) of the *Companies Act* 71 of 2008.
204 Cassim *et al Contemporary Company Law* 910.

will be stopped.[205] The absence of the protection of *moratorium* exposes the company to legal claims such as being sued for breach of contracts, and under the method of business rescue, these claims are halted.[206]

What is more, is that the unsatisfied creditors can obstruct this process by executing writs against assets of the company in question, especially those assets which the company was trying to protect. Moreover, the renegotiations of the new terms of the contracts between the parties will be ruined. Nevertheless, the automatic application of a *moratorium* can be more beneficial for SMEs as a shield against their difficult creditors.

The application to place the company under provisional liquidation in terms of section 155 of the 2008 *Companies Act* brings the principle of a *moratorium* against the claims of its creditors.[207] However, placing the company under provisional liquidation has financial consequences which are result in burdensome for SMEs.[208] It has been discussed that the method of compromising provided in terms of the section mentioned above, appears to be a method that can be used by all forms of companies; however, this legal framework needs to be adjusted to make it possible for the company to be rescued.[209] Therefore, there is a need for a suitable restructuring for SMEs and that can be achieved when the present section 155 of the 2008 *Companies Act* is modified by permitting the application of automatic *moratorium* against the difficult creditors. This will help both parties to make appropriate arrangements without interference.

3.8 Conclusion

It is expected that a method of business rescue will experience hiccups since it has been introduced recently in South Africa. The business rescue provided by the 2008 *Companies Act* was found to be beneficial for financially distressed companies compared to judicial management provided by 2008 *Companies Act*. This method

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205 Cassim *et al Contemporary Company Law* 910.
206 Section 131 and 136(A) of the *Companies Act* 71 of 2008.
207 Klopper and Bradstreet 2014 *Stell LR* 557.
208 Klopper and Bradstreet 2014 *Stell LR* 557.
209 Klopper and Bradstreet 2014 *Stell LR* 557.

allows the company in financial distress to redeem itself by restructuring to reduce their financial problems, and it restores the trust of the investors and the creditors.

Moreover, it promotes the notion that when all affected parties cooperate as a unit to rescue the company in a financially distressed situation, it is likely that the process of business rescue will succeed. Consequently, this reduces the amount of burden faced by the company in question and this promotes South African company law to be in line with international standards.

The study showed the problems that financially distressed companies encounter when they apply the method of business rescue to restructure themselves. It is clear that SMEs in financial distress do resort to business rescue, but it is not as effective as it is expected to be. Likewise, the current legal framework needs to be amended since SMEs it is only effective for large enterprises. For example, restrictions need to be stipulated on business rescue practitioners' fees. Also, the SMEs need to be afforded an automatic *moratorium* in terms of section 155 of 2008 *Companies Act*.

These amendments to this section will be more beneficial for SMEs in financial distress than a procedure of business rescue which results in burdensome fees for these enterprises. Therefore, business rescue in South Africa is not effective for SMEs in financial distress; even the alternative methods provided by 2008 *Companies Act* to rescue these enterprises still have shortfalls. Consequently, most of these enterprises will close down since it will be difficult for them to access the appropriate method to restructure. The conclusion and recommendations of business rescue concerning the new regime after 2008 in South Africa will be discussed in the following chapter.

CHAPTER 4

Recommendations and Conclusion

4.1 Introduction

Access to business rescue is important in the current economy, where many businesses are facing financial distress in South Africa.[210] Consequently, not all of these applications of business rescue will be monitored, and this will open the door for abuse of this process by the creditors, the company which is financially distressed and business rescue practitioners. Moreover, SMEs are found to be contributing positively towards South Africa's socio-economic development by providing formal and informal work skills, and employment for members of society.[211] On the other hand, history has shown that a great number of these enterprises are closing down at a rapid pace when they are in financial distress in this country due to a lack of access to business rescue and any other alternative method of restructuring.[212]

This leads to the idea that the current methods of restructuring provided by the 2008 *Companies Act* have to be amended to better accommodate SMEs.[213] The

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210 Steinacker 2020 https://www.timeslive.co.za.

211 Ngary, Smit and Bruwer *MJSS* 911; Liedkte 2019 http://m.engineeringnews.co.za.

212 Department of Statistics of South Africa 2020 http://statssa.gov.za; Businesstech 2020 http://businesstech.co.za.

213 Section 155 and chapter 6 of the *Companies Act* 71 of 2008.

research question of this work is: does the 2008 *Companies Act* make provision for effective business rescue methods for SMEs? The objective of the study is to determine if the exorbitant business rescue practitioners' fees hinder business rescue for SMEs. Do the requirements for business rescue make the process inadequate for SMEs? How the informal business rescue process could be adapted to give more protection to SMEs. It was found that the 2008 *Companies Act* does not provide adequate provisions to rescue financially distressed SMEs. Therefore, the amendment of these methods will serve the interests of these SMEs in financial distress and their survival will benefit the country and the public in general.

4.2 Recommendation

The study above shows that there is a need for a reasonable process of business rescue that is effective for SMEs in South Africa, and the scholar proposes the following recommendations.

4.2.1 The formal and informal regime of business rescue

Rajak and Henning proposed that it is important for South Africa to introduce formal and informal regime processes of business rescue for SMEs.[214] It is clear from the proposal mentioned above that the size of the company in financial distress will be used as one of the factors to determine whether the method of business rescue for that company will be formal or informal; another factor will be the profit they make per year and a third factor will be their employment scale. The use of the formal and informal processes of business rescue will be beneficial for SMEs as will be indicated below.

4.2.1.1 The formal procedure for company restructuring

Section 128 of the 2008 *Companies Act* provides a formal process of business rescue that a company and other affected persons can use to restructure a company in financial distress in South Africa. This process was found to be restrictive, due to the requirements that a company must meet for this process to apply to it. In my

[214] Rajak and Henning 1999 *SALJ* 268.

opinion this procedure is more suitable for bigger companies and not for SMEs. The reason why this procedure must apply to the bigger companies only, is that these companies can meet the expense of this procedure, including administrative expenses and the period of time which this procedure will take. SMEs cannot meet the expenses of business rescue, and the requirements of this procedure are far from being accessible by these enterprises.

4.2.1.2 The informal procedure of company restructuring

Apart from the procedure mentioned above, there is an informal procedure to restructure the company in financial distress. For example, section 155 of the 2008 *Companies Act* provides an informal procedure that a company or its liquidator can use to restructure the company in financial distress. This procedure is called compromising between the company in financial distress and its creditors to renegotiate the old terms of their contract.

This procedure is available to all companies in South Africa, it is much more flexible, and its costs are less compared to the formal procedure. Moreover, it was found to be an advantage for SMEs in financial distress since it is cheap to use. Furthermore, it has been shown that these enterprises are not accommodated in terms of the formal procedure. Therefore, the informal procedure seems to be more applicable for these enterprises.

4.2.2 The application of the automatic moratorium

The procedure provided by section 155 of the 2008 *Companies Act* allows the SMEs to restructure its business without the presence of a business rescue practitioners and their services. Consequently, this assists these enterprises to save money that was supposed to be paid to these practitioners. However, this procedure remains burdensome for SMEs since there is no application of automatic *moratorium*, and this means these enterprises are not protected from legal claims. The principle of the *moratorium* is used to protect the company under the process of restructuring against legal claims, especially from its non-cooperative creditors.

The scholar recommends that once the enterprise is in the process to compromise with its creditors, then the *moratorium* must automatically apply to it. The *moratorium* must be applicable until the process of compromising is complete because it will be to the advantage of all relevant parties. Therefore, adding a *moratorium* in provisions of section 155 of the 2008 *Companies Act* will assist the enterprise in financial distress to restructure without the legal actions from its creditors or any person. Therefore, this process will benefit all parties in the long run, should business rescue succeed.

4.2.3 The subsidies from the Government

The South African government acknowledges the importance of SMEs and their contribution towards socio-economic development.[215] The government should introduce a program that deals specifically with business rescue for SMEs in this country, since it is a challenge for them to receive help when they are facing financial difficulties. It will assist SMEs if the government subsidises the costs of business rescue for SMEs. Above all, this will make the procedure of business rescue accessible for these enterprises, the success rate of this procedure will increase, and more jobs will be secured. The South African government advocates for small business investment with the aim to create more jobs and eradicating poverty, and subsidising this procedure will protect the resources already invested in these enterprises.

The scholar recommends that the provisions of the procedure of business rescue found in the 2008 *Companies Act* must be reviewed, since it is burdensome for SMEs. The review will make the procedure of business rescue accessible for SMEs and this will further contribute towards the socio-economic development of this country.

4.2.4 Business Rescue Practitioners security

[215] Ngary, Smit and Bruwer *MJSS* 911.

The duty of Business Rescue Practitioner is to assist financially distressed company and to protect the interests of employees, the government and other relevant parties. It will serve a very important purpose for appointed practitioners to provide security to curb any act of abuse when they perform their duties.

4.2.5 Appointment of Business Rescue Practitioners

The provisions of the 2008 *Companies Act* are silent when it comes to the appointment of a company as a business rescue practitioner. The duties of these practitioners are clear: they are required to be experts in terms of law, business management and accounting. This study recommends that the current Act should include provisions for the appointment of a company as the practitioner mentioned above. It will be time-effective as the company will bring experts and brainstorming will not be a challenge to formulate effective solutions.

4.3 Conclusion

The study has shown that SMEs in South Africa are important for socio-economic development.[216] For example, these enterprises create more job opportunities than larger companies and provide formal and informal working skills and therefore these enterprises are needed for the growth of the South African economy.[217] The government of this country acknowledges the importance of these enterprises also acknowledges them as the basic foundation of its business industry. The scholar believed that there is a need for the establishment of more of these enterprises as they eradicate poverty and create more employment opportunities.[218] However, the failure rate of SMEs in financial distress in this country is alarming.[219] The failure rate of these enterprises is because business rescue is not to their advantage.[220] This leads to the idea that there is a necessity for the present business rescue

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216 Ngary, Smit and Bruwer *MJSS* 911; Liedkte 2019 http://m.engineeringnews.co.za.

217 Ngary, Smit and Bruwer *MJSS* 911; Liedkte 2019 http://www.m.engineeringnews.co.za and Elizur 2020 http://www.ventureburn.com.

218 Ngary, Smit and Bruwer *MJSS* 911; Liedkte 2019 http://www.m.engineeringnews.co.za.

219 Mathe and Smit 2021 http://www.mg.co.za.

220 Mathe and Smit 2021 http://www.mg.co.za.

method, found under chapter six of the 2008 *Companies Act*, to be amended to accommodate these enterprises.

Closing down of SMEs will harm the economy of this country and most employees will lose their jobs.[221] Amending the provisions of this procedure will promote the survival of these enterprises and jobs will not be at risk. Moreover, the development of business rescue has shown that judicial management has failed dismally when it comes to rescuing financially distressed companies. The main reason behind the failure of judicial management is that companies in financial distress were barely using it and it was not accessible to these companies.

Moreover, judicial management was hardly regulating the remuneration of business rescue practitioners and this added to the reasons not to use it. What is more is that these companies would have no choice but to close down their operations and there would be loss of jobs, and loss of investments of creditors. Therefore, SMEs were burdened by the procedure provided by judicial management.

The Department of Trade and Industry saw fit to introduce the procedure of business rescue which meets the international standard in South Africa. This procedure is found under chapter six of the 2008 *Companies Act*. This procedure introduced an improved attitude towards the restructuring of companies in financial distress, and the company in question will be protected against legal claims in terms of a *moratorium* until the process of rescue company is completed. When the company has been rescued then its creditors will expect better returns, as opposed to the situation where the process to rescue the company failed.

It is a known fact that the procedure to rescue a company that is financially distressed, found in 1973 *Companies Act*, has not been beneficial compared to the one found in 2008 *Companies Act*. Regardless of these benefits, the procedure

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221 Mahembe 2011 http://www.ncr.org.za/pdfs/Literature%20Review%20on%20SME%20Access%20to%20Credit%20in%20South%20Africa_Final%20Report_NCR_Dec%202011.

found in 2008 *Companies Act* was found to be a burden for SMEs in financial distress, and this means these enterprises are not protected by this procedure.

According to this procedure, there is a specific officer that must be appointed to rescue the company in question.[222] This officer is called a business rescue practitioner and is remunerated for his or her services.[223] However, the remuneration of this officer is expensive for SMEs in financially distressed circumstances. The requirements of the process of business rescue are formal and hardly accessible for these enterprises.[224] For example, these enterprises are making a monthly profit that is hardly keeping up with the remuneration that a business rescue practitioner charges per day.[225] Likewise, the company was required to be already financially distressed to qualify to make use of business rescue and this requirement made it impossible for most of these enterprises to access this procedure.

More importantly, the 2008 *Companies Act* does provide for an informal and a formal procedure to rescue the companies in financial distress, but this regime is not exactly the same as the regime recommended by Rajak and Henning. These scholars found it to be appropriate for South Africa to introduce a dual regime that makes it possible to rescue all enterprises regardless of their size.[226] One can argue that, if South Africa had adopted the recommendation of these scholars, most of the enterprises in question could have been rescued. Since the government of this country acknowledges the importance of these enterprises, it is going to make more sense if they introduce a powerful mechanism to protect these enterprises in financially distressed circumstances. Therefore, if this dual regime were introduced

222 Section 138 of the *Companies Act* 71 of 2008.
223 Section 143 of the *Companies Act* 71 of 2008.
224 Mahembe 2011 http://www.ncr.org.za/pdfs/Literature%20Review%20on%20SME%20Access%20to%20Credit%20in%20South%20Africa_Final%20Report_NCR_Dec%202011.
225 Mahembe 2011 http://www.ncr.org.za/pdfs/Literature%20Review%20on%20SME%20Access%20to%20Credit%20in%20South%20Africa_Final%20Report_NCR_Dec%202011.
226 Rajak and Henning 1999 *SALJ* 268.

as those scholars recommended, then the process of business rescue will be accommodative for SMEs in this country.

Section 155 of the 2008 *Companies Act* affords the company with its creditors an alternative method to restructure by a way of compromising. The provisions of this section allow both parties to set up a meeting and renegotiate their previous terms to conclude new terms of their contract. In this way, the creditors would afford the company a grace period to rescue itself through restructuring.[227] This method is flexible because it can allow a company an opportunity to make use of the method without being financially distressed. Moreover, the services of business rescue practitioners are not needed in this method. As a result, SMEs are saved from making payments of administration fees when they are using this method to restructure.

However, this method does not provide these enterprises with the protection of automatic *moratorium,* which means they are exposed to legal claims from difficult creditors. The difficult creditors may use this situation to their advantage by selling some of the assets of the enterprise to recover the amount of money the enterprise in question owes him or her, and subsequently, this interferes with a process of restructuring. However, the company may be placed under provisional liquidation, which provides the enterprise with a temporary *moratorium*.

The old South African legislations were not meeting the international standard; that is why this legislation called the 2008 *Companies Act* was introduced. On the other hand, the business rescue method found in this new legislation happens to be a failure for SMEs and there is a need for its development. Consequently, this method has many shortcomings and the SMEs in financial distress cannot access this method. There is a need for the process of business rescue to move from formal to informal, to formulate a suitable restructuring method for SMEs. In this case, this method is accessible to these enterprises and its success rate in rescuing these

[227] Section 155 of the *Companies Act* 71 of 2008.

enterprises will increase. Therefore, the study above has shown that the present regime of business rescue must be amended to accommodate SMEs in South Africa.

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