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Qualification: Post- graduate Diploma in Law

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Word Count: 9854

Title: Suggested Reasons for the failure of Judicial Management as a Business rescue Mechanism in South African Law.

Research Paper presented for the approval of Senate in fulfilment of part of the requirements for the post-graduate diploma in law in approved courses and a research paper. The other part of the requirement for this qualification was the completion of a programme of courses.

I hereby declare that I have read and understood the regulations governing the submission of post-graduate diploma research papers, including those relating to length and plagiarism, as contained in the rules of this University, and that this research paper conforms to those regulations.

University of Cape Town

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## Abstract:

In 1926, the South African Parliament introduced a procedure known as judicial management.<sup>1</sup> It was housed in the Companies Act 46 of 1926 (hereafter Companies Act 1926). The purpose of judicial management was to enable a failing company to restructure thus providing an alternative to liquidation.<sup>2</sup> Companies play an important role in an economy and their demise affects not only creditors but also different groups of people that have a working relationship with the company.<sup>3</sup> These include employees, suppliers, shareholders and other stakeholders. The legislature recognised the need to save this relationship in as far as was possible. They attempted to do so by amongst other things, providing for judicial management.

Judicial management provided breathing space to companies on the brink of collapse in order to allow them to re-organise their affairs. It tried to achieve this by providing for a moratorium against creditors<sup>4</sup>, divesting the control of the company from previous management who assumedly had run it aground, and by providing for the appointment of a judicial manager who attempted to turn the company around.<sup>5</sup>

Due to several factors, judicial management was not much of a success<sup>6</sup> as will be discussed in this paper. Some of the reasons are related to weaknesses in the legislation, the attitude of the courts<sup>7</sup> and in my view, the lack of local precedents initially, for the courts to

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<sup>1</sup> A Loubser *Some Comparative aspects of corporate rescue in South African Company Law* (2010) LLD, University of South Africa at ii.

<sup>2</sup> Under the Companies Act 61 of 1973 s 427, judicial management was to be used by a company when due to mismanagement or any other reason it was unable to pay its debts, meet its obligations and has not or is prevented from becoming a successful concern. There had to be a reasonable probability that if placed under judicial management, it would be enabled to pay its debts or meet its obligations and become a successful concern.

<sup>3</sup> A Loubser 'Judicial management as a business rescue procedure in South African corporate law' (2004) 16 *SA Merc LJ* 137 at 137.

<sup>4</sup> The Companies Act 1973 s 428(2)(c) stipulates that the court has discretion to grant a moratorium on all actions against the company. No action may be brought against the company without the courts permission. A moratorium is quite instrumental to a company achieving the objectives of judicial management. The fact that this was not automatic and in some cases was not granted could have contributed to the limited success achieved by judicial management as is argued in chapter 3 of this paper.

<sup>5</sup> Companies Act of 1973 s 428(2)(a).

<sup>6</sup> DA Burdette 'Some Initial thoughts on the Development of a Modern and effective Business Rescue Model for South Africa (Part 1)' (2004) 16 *SA Merc LJ* at 241. The author refers to the case of *Le Roux Hotel management (Pty) Ltd v E Rand (Pty) Ltd and another* 2001 (1) SA 223 (C) para 39 at 233 where the court gives a summary of the problems associated with judicial management and by implication reasons for its limited success.

<sup>7</sup> P Kloppers 'Judicial management reform— steps to initiate a business rescue' 13(2001) *SA Merc LJ* 358 at 376, *Le Roux Hotel Management (Pty) Ltd and another v E Rand (Pty) Ltd and another* 2001 (1) SA 223 (c) par 39 at 233. Josman J in his judgement explains that since the interpretation of the Companies Act 1973 was left to the courts, '[their] inherent conservatism led to a restrictive rather than a progressive interpretation' of judicial management.

follow (seeing that judicial management was the first of its kind in South African law) as well as companies themselves, who might have lacked an idea of how the procedure was to be utilised.

In order to address the shortfalls in the legislation, a number of amendments were made through the years. One such shortfall was the fact that many companies that applied for judicial management had no real chance of rehabilitation and only did so to avoid a liquidation that was subject to the winding-up provisions of the 1926 Act.<sup>8</sup>

Some notable amendments that were made include those in 1932 under s 196(1) that provided for a moratorium to be placed on all actions against the company while it was undergoing judicial management.<sup>9</sup> Section 197(A) introduced the concept of voidable dispositions as it applied in insolvency law. This provision aimed to ensure that companies did not apply for judicial management because they did not want the company to be wound up subject to the rules of insolvency law.<sup>10</sup>

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<sup>8</sup> AH Olver *Judicial Management in South Africa* (1980) PHD, University of Cape Town at 3. If a company was wound up, then the law of insolvency came in to play which has more onerous requirements than judicial management. To avoid this, even where there was little to no chance of judicial management succeeding, the company would nevertheless elect to carry out judicial management. This in essence enabled the company to be wound-up short of the grips of the insolvency provisions.

<sup>9</sup> Companies amendment Act 1932 s 196(1).

<sup>10</sup> AH Olver op cit note 8.

Aim of research:

Much of the commentary on judicial management suggests that the procedure was flawed and that it was a dismal failure.<sup>11</sup> The intention of this paper is to put forward suggestions as to why judicial management failed. These will be based on an analysis of the 1926 Act that introduced the procedure into South African law and its subsequent amendments.

In order to achieve the above objective, in chapter one I discuss the development of judicial management. From its initial promulgation into law, to the notable amendments, its use, and finally its repeal and replacement by business rescue in the Companies Act 71 of 2008.

In chapter two I discuss judicial management in detail with reference to the Companies Act 61 of 1973.

Chapter three aims to achieve the purpose of this paper— i.e. putting forth suggested reasons as to why judicial management was a failure. These reasons range from shortcomings in the legislation to the lack of a framework that could support a proper application of judicial management. These reasons will be backed up by commentary made by the leading authorities on corporate rescue in South Africa in the past and present.

In chapter four I introduce business rescue as the successor of judicial management. I analyse some provisions of business rescue which seem to be a direct response by the legislature to address the short-falls of judicial management.

Chapter five is the last one and I attempt to draw on a conclusion. Based on the findings, I will determine the most dominant factors that led to the failure of judicial management and assess whether it was the law that was inadequate, whether it was a novel procedure way ahead of its time that the courts and business community were not ready for, or perhaps any other reasons.

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<sup>11</sup> AH Olver op cit note 8.

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## Chapter 1: Introduction.

### 1.1: Origins of judicial management:

Judicial management was introduced into South African law by the Companies Act 1926. Its exact origins remain unknown.<sup>12</sup> Several theories exist as to where it came from. The one suggests that it came from discussions in the English case of *Moss Steamship Co Ltd v Whinney*<sup>13</sup> where the Lord Halsbury explained that:

‘When joint stock companies needed to obtain capital, they issued debentures. In order to secure the debenture holders in their rights, the company used a form of application to court which removed the conduct and guidance of the company from its directors and placed it in the hands of the receiver and manager’.<sup>14</sup>

The concept of receiver and manager was one in English law where a ‘receiver’ was appointed by debenture holders. His role was to take charge of the property (of the company) which constituted security for a debenture. His sole function was to protect the interests of secured creditors. If carrying on the business of the company was necessary, a manager was appointed to do so, as this did not form part of the receiver’s mandate.<sup>15</sup> Despite this, there is no concrete evidence to suggest that judicial management was derived from the English procedure of receiver and manager. In addition, although some similarities exist, there are some vital distinctions. A receiver and manager are not concerned with the rehabilitation of the business of the company and are concerned only with secured creditors. On the other hand, a judicial manager’s role is amongst other things to protect the interests of the whole body of creditors as well as shareholders, as well as endeavour to rehabilitate the company.<sup>16</sup>

In the United States, a procedure for re-organising insolvent railroad companies was developed in the late 19<sup>th</sup> century. It was called ‘Federal equity consent receivership’. Here, creditors of failing railroad corporations would approach a federal court with jurisdiction and show a need to preserve the liquid assets of a corporation. A plan of re-organisation would then be negotiated and approved by the court. This practise was partly codified in the U.S. Bankruptcy Act of 1898 under s 77.<sup>17</sup>

The above practises in the United States and in England may have motivated the South African Parliament to enact the provisions on judicial management. In fact, when the second reading of the consolidated Companies Bill was taken in Parliament in February 1923,

<sup>12</sup> A Loubser op cit note 3 at 139.

<sup>13</sup> *Moss Steamship Co Ltd V Whinney* [1912] AC 254 at 260.

<sup>14</sup> AH Olver op cit note 8 at 14.

<sup>15</sup> Ibid at 18.

<sup>16</sup> Ibid at 19.

<sup>17</sup> Encyclopaedia Britannica 17(1971) at 22.

the then Minister of Justice did mention that judicial management was derived from practises in England and the United States as described above.<sup>18</sup>

### 1.2: Important amendments to the judicial management provisions:

Due to some practical difficulties, judicial management underwent a number of amendments. One of such, as noted by the Millin Commission in 1948, was the difficulty faced by the courts in assessing whether there was a reasonable probability that the company would overcome its difficulties if placed under judicial management.<sup>19</sup> This issue as well as others, together with the amendments are discussed later in this chapter.

#### 1.2.1: Companies law amendment Act 11 of 1932:

It was through this amendment that we first saw the concept of the moratorium.<sup>20</sup> Under s196 (1) the court was allowed to order a stay of any action against the company for the duration of judicial management and such could only be pursued on application to court. The moratorium is quite vital to a company which wishes to overcome its financial difficulties. It allows the company to continue and focus on business as opposed to any possible law suits. Although this was a development, it is necessary to note that the court was not required to grant the moratorium. It was a matter that the court had discretion over provided the applicant had made their case.

The above amendment also introduced the concept of voidable dispositions, as it applied in insolvency law to judicial management.<sup>21</sup>

#### 1.2.2: Companies law amendment Act 23 of 1939:

One of the difficulties faced relating to judicial management, as mentioned in 1.2 above, was the fact that the courts lacked sufficient evidence to determine whether a company had a reasonable probability of overcoming its difficulties<sup>22</sup> and therefore grant the order of judicial management. This was addressed by an amendment to s 195 which required an application to be referred first, to the Master of the Supreme Court for a report. The Master was to investigate and determine whether the company had a chance of being saved. This proved unsuccessful because the Master in any case lacked the means to carry out such an investigation. The amendment did little to curb this problem.

The amendment also brought about a new s 197(B) which directed the judicial manager to use any money that became available, to pay the costs of the judicial management

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<sup>18</sup> AH Olver op cit note 8 at 2.

<sup>19</sup> Final report of the Company Law amendment Enquiry commission UG 69 1948 93.

<sup>20</sup> AH Olver op cit note 8.

<sup>21</sup> AH Olver op cit note 8 at 6.

<sup>22</sup> Ibid.

as well as creditors in accordance with the law relating to insolvency. This brought on a situation where judicial managers would make no serious attempt to revive the business of the company. Instead, they would proceed as a liquidator would, paying creditors and performing the role of liquidator. The only difference was that they were wearing the hat of a judicial manager.<sup>23</sup>

#### 1.2.3: Companies Act 61 of 1973:

The Companies Act commission of enquiry under the chairmanship of Hon. Justice van Wyk de Vries reporting in 1970 cited recommendations for a restructuring of judicial management. These were embodied in the Companies Act 1973 and are dealt with in detail in chapter 2.

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<sup>23</sup> Ibid at 9.

## Chapter 2: Judicial management under the Companies Act 61 of 1973:

Judicial management as it appears in the Companies Act 1973 Act was as a result of the several amendments it went through as discussed above. Chapter XV of the Act contained all the provisions relating to judicial management. Section 427 introduced the chapter and provided the circumstances under which a company could apply to court for an order of judicial management. This and other aspects of judicial management are discussed at length in this chapter.

### 2.1: Commencement of judicial management:

A company could approach the court for a judicial management order when it was unable to pay its debts, unable to meet its obligations, and has not become or is prevented from becoming a successful concern by reason of mismanagement or for any other cause.<sup>24</sup> This cause must be identified by the company.<sup>25</sup> Furthermore, the company had to show that there was a reasonable probability that it would be able to pay its debts. The court also had a discretion to grant the order if it was just and equitable to do so.<sup>26</sup> The persons entitled to apply to court for the judicial management order are the same as those that would be entitled to apply to court for the winding up of a company.<sup>27</sup> These are, the company itself, one or more of the creditors (including contingent and prospective), one or more of the members of the company, the Master in the case of a company being wound up voluntarily and a provisional judicial manager if a final order was being sought.<sup>28</sup>

If on application for a winding up order, it appeared to the court that if the company were placed under judicial management, the grounds for its winding up may be removed *and* the company would become a successful concern *and* it was just and equitable to do so, an order for judicial management could be made.<sup>29</sup> The use of the word *and* suggests that all these requirements had to be met and they were not alternative requirements to the granting of the judicial management order in these circumstances, as would be the case if the word *or* had been used. There had to be a strong probability as opposed to a mere possibility of the company becoming a successful concern.<sup>30</sup> In *Tenowitz v Tenny Investments (Pty) Ltd*<sup>31</sup> the

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<sup>24</sup> Companies Act 61 of 1973 s 427 (hereafter Companies Act 1973).

<sup>25</sup> *Ex parte Onus (Edms) Bpk; Du Ploy V Onus (Edms) BPK* 1980 (4) SA 63 (O) at 66.

<sup>26</sup> Companies Act 1973 s 427(3).

<sup>27</sup> Companies Act 1973 s 427 (2).

<sup>28</sup> Companies Act 1973 s 346(1).

<sup>29</sup> Companies Act 1973 s 427.

<sup>30</sup> Cilliers, Benade, Henning & others *Corporate Law* 2 ed (1992) par 27.10 p 477.

<sup>31</sup> *Tenowitz and another V Tenny Investments (Pty) Ltd* (3) 1979 SA 479 (E) at 481.

court was of the view that the onus of proving this was different depending on whether a final or provisional judicial management order was being sought; the former having a heavier onus.

The just an equitable requirement suggests that creditor and shareholder interests must be considered.<sup>32</sup> It is important to note that the courts would not grant an order if the company itself is capable of remedying the problem that led to its circumstances, by for example changing the board of directors.<sup>33</sup> It is only if the share-holders are incapable of remedying the problem that the court will intervene. An order for judicial management will also not be granted on the grounds that the company will be run more efficiently and could make a higher profit.<sup>34</sup>

#### 2.1.1: Provisional judicial management order:

On application for the judicial management order, the court may grant a provisional one, stating the return day or dismiss the application or make any other order it deems fit.<sup>35</sup> The provisional order shall contain directions that the company shall be under the management of a provisional judicial manager subject to the supervision of the court and any management shall be divested of control of the company.<sup>36</sup> The provisional judicial manager is given the right to raise money in any way (as the court may consider necessary), subject to the rights of creditors without prior shareholder approval.<sup>37</sup>

#### 2.1.2: Custody of property and appointment of provisional judicial manager on the granting of judicial management order:

After the granting of the provisional judicial management order, all the property of the company shall be deemed to be in the custody of the Master until a provisional judicial manager has been appointed and has assumed office.<sup>38</sup> More than one judicial manager may be appointed. However, since this would increase the costs to be borne by the company, fewer would be preferable.<sup>39</sup>

The Master is to appoint a provisional judicial manager (who may not be the auditor of the company or any person disqualified from being a liquidator) who is to give security for the proper performance of his duties and who shall hold office until discharged by the court.<sup>40</sup>

<sup>32</sup> *Repp v Ondudu Goldfields Ltd* 1937 CPD 375 at 379-381.

<sup>33</sup> Cilliers, Benade, Henning & others op cit note 30 at 478.

<sup>34</sup> *Makhuva v Lukhoto Bus Service (Pty) Ltd* 1987 3 SA 565 (v) at 586.

<sup>35</sup> Companies Act 1973 s 428.

<sup>36</sup> Companies Act 1973 s 427.

<sup>37</sup> Companies Act 1973 s 428.

<sup>38</sup> Companies Act 1973 s 346(1).

<sup>39</sup> *Meskin & others Henochsberg on the Companies Act 61 of 1973* 5ed 935.

<sup>40</sup> Companies Act 1973 s 428.

Under s 428(ii), the Master is charged with convening separate meetings of the creditors, the members and debenture holders.

#### 2.1.3: Duties of provisional judicial manager upon appointment:

The provisional manager assumes the management of the company. He is to prepare and lay before meetings convened under s 429 (b) a report containing-

- i) An account of the general affairs of the company
- ii) A statement of the reasons why the company is unable to pay its debts or is probably unable to meet its obligations or has not become or is prevented from becoming a successful concern;
- iii) A statement of the assets and liabilities of the company
- iv) A complete list of creditors of the company (including contingent and prospective) and the amount and the nature of the claim of each creditor
- v) Particulars as to the source or sources from which money has been or is to be raised for purposes of carrying on the business of the company; and
- vi) The considered opinion of the provisional judicial manager as to the prospects of the company becoming a successful concern and of the removal of the facts or circumstances which prevent the company from becoming a successful concern.<sup>41</sup>

#### 2.1.4: Purpose of meetings convened under s 429(b)(ii):

According to s 431, any meeting convened under s 429 (b) shall be presided over by the Master or a magistrate having jurisdiction in the area where the meeting is held and shall be convened and held in the manner prescribed by s 412 – i.e. in the manner prescribed for the holding of meetings of creditors under insolvency law.

Under s 431(2) the purpose of any such meetings is mentioned. Among them are to consider the report of the provisional judicial manager and the desirability of placing the company under a final judicial management order, to nominate persons to be the final judicial manager and in the case of creditors, to prove claims against the company.

The chairman of the meeting above is to prepare and lay before the court a report of the proceedings of any such meeting including a summary of the reasons for arriving at any conclusions made.<sup>42</sup>

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<sup>41</sup> Companies Act 1973 s 430.

<sup>42</sup> Companies Act 1973 s 431(3).

### 2.1.5: Return day of provisional order of judicial management and powers of the court:

The return day fixed under s 428 (1) shall not be later than sixty days after the date of the provisional judicial management order but may be extended by the court on good cause shown.<sup>43</sup>

On such return day, the court may after consideration of the opinion and wishes of creditors and members of the company, the report of the provisional judicial manager, the report of the master and the report of the registrar grant a final management order if it appears to the court that the company will achieve the goals envisaged in s 427, or it may discharge the provisional order or make any order it deems just.<sup>44</sup>

The final management order shall contain directions for the vesting of the control of the company in the final judicial manager subject to the supervision of the court, and such other directions as to the management of the company or any matter incidental thereto.<sup>45</sup> The court which grants the final order may at any time and in any manner vary such on application by the master or, final judicial manager or a representative acting on behalf of the general body of creditors of the company.<sup>46</sup>

### 2.1.6: Duties of final judicial manager.

A judicial manager shall, subject to the provisions of the memorandum and articles of the company, in so far as they are not inconsistent with any direction contained in the relevant judicial management order perform the duties stated in s 433 of the Act. These are quite extensive and I shall only discuss them in summary. The final judicial manager is to take over from the provisional judicial manager and assume management of the company.<sup>47</sup> He is to do so subject to the orders of the court in a manner that promotes the interests of the members and creditors of the company.<sup>48</sup>

The final judicial manager is to lodge with the registrar—

- i) A copy of the judicial management order and of the Master's letter of appointment under cover of the prescribed form;
- ii) In the event of the judicial management order being cancelled, a copy of the order cancelling it, within seven days of his appointment or of the cancellation of such judicial management order, as the case may be;<sup>49</sup>

<sup>43</sup> Companies Act 1973 s 432.

<sup>44</sup> Companies Act 1973 s 427.

<sup>45</sup> Companies Act 1973 s 432(4).

<sup>46</sup> *Repp V Ondudu Goldfields Ltd* supra note 32.

<sup>47</sup> Companies Act 1973 s 433(a).

<sup>48</sup> Companies Act 1973 s 433(b).

<sup>49</sup> Companies Act 1973 s 433(d).

He is to fulfil the role of keeping accounting records and prepare annual financial statements as would the management, had the company not been placed under judicial management.<sup>50</sup>

He must convene meetings of creditors,<sup>51</sup> examine the affairs of the company prior to judicial management to ascertain whether any past director or officer of the company had contravened the Act or committed any other offence<sup>52</sup> or appears personally liable for any damages or compensation to the company<sup>53</sup>.

If at any time, the judicial manager is of the opinion that the continuation of the judicial management will not enable the company to become a successful concern, he must apply to court after not less than fourteen days' notice by registered post to all members and creditors of the company, for the cancellation of the relevant judicial management order and the issue of an order for the winding up of the company.<sup>54</sup>

#### 2.1.7: Application of assets during judicial management:

Section 434 governs the disposal of company assets while under the judicial management order. The judicial manager may not sell or dispose of the company assets without the leave of court unless such is done in the ordinary course of business.<sup>55</sup> These provisions do not apply where such sale is done where the judicial manager has failed to bring about the objects of s 427 and such sale is a pre-cursor to winding up.<sup>56</sup> Moneys that become available to the manager shall be used to pay the costs of judicial management, the conduct of the business of the company and payment of pre-judicial management creditors in as far as is possible.<sup>57</sup> The costs of judicial management and the claims of creditors are to be paid in accordance with the law relating to insolvency.<sup>58</sup>

#### 2.1.8: Remuneration of provisional judicial manager or judicial manager:

The rate of remuneration of the judicial manager is determined by the master who shall take into account the manner in which the former has performed his duties and any recommendation by the members or creditors of the company.<sup>59</sup> Certain uniform guidelines have been laid down by the chief master for the purposes of assisting the master in the

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<sup>50</sup> Companies Act 1973 s 433(f).

<sup>51</sup> Companies Act 1973 s 433(h).

<sup>52</sup> Companies Act 1973 s 433(j).

<sup>53</sup> Companies Act 1973 s 433(k).

<sup>54</sup> Companies Act 1973 s 433(l).

<sup>55</sup> Companies Act 1973 s 434(1).

<sup>56</sup> *Ex parte Onus (Edms)* supra note 25.

<sup>57</sup> Companies Act 1973 s 434(2).

<sup>58</sup> Companies Act 1973 s 434(3).

<sup>59</sup> Companies Act 1973 s 434 A.

taxation of fees of trustees, liquidators and judicial managers.<sup>60</sup> According to s 434 A (3), the master's decision as to the amount of remuneration may be brought under review in terms of Insolvency Act.

2.1.9: Pre-commencement creditors may consent to preference:

Under s 435(1)(a), unpaid pre-commencement creditors (creditors before the judicial management order) may consent to the liabilities incurred by the judicial manager in the conduct of the company's business having a preference over their claims. However, if a judicial management order is superseded by a winding up order, the preference conferred as mentioned above shall only remain in force in so far as claims arising out of the costs of winding up are concerned.

2.1.9.1: Voidable and undue preferences in judicial management:

This section allows the judicial manager to approach court to set aside a disposition of property in the event that the company is placed under judicial management.<sup>61</sup>

2.1.9.2: Cancellation of the judicial management order:

This may be done when the purpose for which the order was sought has been achieved or it has become undesirable for the order to remain in force. The court may then give directions as to who is to assume management of the company including directions for the convening of a general meeting to elect directors of the company.<sup>62</sup>

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<sup>60</sup> Companies Act 1973 s 428.

<sup>61</sup> Companies Act 1973 s 436.

<sup>62</sup> Companies Act 1973 s 440.

### Chapter 3: Suggested reasons for the failure of judicial management:

Despite the fact that the legislature made attempts to address weaknesses in the legislation, judicial management was not very successful. This is in part due to the fact that its failure is attributed to more than just weaknesses in the Act, but also to the absence of an appropriate social/institutional framework within which judicial management could thrive i.e. the courts treated it an extra-ordinary remedy( see chapter 3.2) and companies were more familiar with the liquidation route and utilised it instead. In this chapter, the reasons for the failure of judicial management are categorised under the headings of ‘short-comings in the legislation’ and ‘social context’. These are examined in some detail below.

#### 3.1: Short-comings in the legislation:

There was a heavy reliance on the courts.<sup>63</sup> This created a problem due to the costs associated with approaching the courts. When a company is facing financial troubles, the last thing on the mind of the management is to spend more money, which in any case was limited.<sup>64</sup> The need to approach the courts (as required by the Act) might have created a deterrent effect for would be users of the procedure which would have decreased its popularity. Furthermore, the court had to grant two orders, a provisional<sup>65</sup> then a final one.<sup>66</sup> This proved to be cumbersome and lengthy. In addition, the requirement that there *must* be a reasonable probability that the company will become a successful concern<sup>67</sup> posed a heavy burden of proof on the applicant.<sup>68</sup> This could have scared off persons that might have applied for an order even when there was a chance of the company being saved.<sup>69</sup> At the end of the day, judicial management seemed unattractive and rather expensive.

It was not uncommon for companies to apply for a judicial management order when they lacked funds to cover the costs thereof. This was often the case with small businesses.<sup>70</sup> It is conceivable that these applications were often made to stall the repayment of moneys owed and not to save the business.

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<sup>63</sup> H Rajak & J Henning ‘Business Rescue for South Africa’ (1999) 116 *SALJ* 262 at 268.

<sup>64</sup> *Ibid.*

<sup>65</sup> Companies Act 1973 s 428.

<sup>66</sup> Companies Act 1973 s 427.

<sup>67</sup> *Ibid.*

<sup>68</sup> Judicial management would have been more favourable for an applicant had the requirement been ‘a reasonable possibility’. This would have required a lesser burden of proof. DA Burdette ‘Some initial thoughts on the development of a modern and effective business rescue model for South Africa (Part 1)’ (2004) 16 *SA Merc LJ* 241 at 249.

<sup>69</sup> G Mutsa *The development of business rescue in South African law* (2011) LLM Dissertation, University of Pretoria at 16.

<sup>70</sup> AH Olver ‘Judicial management– A case for Law reform’ (1986) 49 *THRHR* 84 at 87. The author raises the argument that a company with gross assets under R10 000, already in financial difficulty cannot bear the costs

The courts had discretion whether or not to grant a moratorium on actions against the company. It was not automatic on the granting of the judicial management order (as is the case with business rescue)<sup>71</sup> In cases, where it was not granted it deprived the company of the much needed ‘breathing space’<sup>72</sup> that is vital to achieving the objectives of judicial management.

The provisions relating to judicial management lacked a mechanism to monitor the progress of the judicial manager. This could have been in the form of a requirement to draft a formal rescue plan and/or strategy.<sup>73</sup> As such, the judicial manager was under no pressure to achieve set objectives within time frames and received his remuneration whether the process was a success or not.

The frequent application of s 311 of the Companies Act 1973 as a corporate rescue strategy undermined judicial management. Section 311 provided for an arrangement or compromise to be made between a company and its creditors or members. This arrangement could have been necessary to alter existing rights in the interest of both the company and/or its members. In practice however, s 311 was used as an avenue for corporate rescue, which in any case contained inadequate safeguards for creditors and less for employees. Kloppers sums this practice up by stating that ‘...section 311 [was] aimed more at the rescue of the corporate shell than the rescue of a viable commercial enterprise capable of making a useful contribution to the economic life of the country’.<sup>74</sup> Through s 311, the company was able to structure its own form of corporate rescue, a form which was not necessarily concerned with restructuring the company. Since companies were able to manipulate s 311 in this way, judicial management was often ignored.<sup>75</sup>

Section 427 (1) (a) required that the company ‘must not be able to pay its debts’ before a judicial management order could be granted. The implication was that the company must be insolvent or on the brink of insolvency. This was counter-productive to the overall

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of judicial management and as such judicial management is not a suitable form of ‘business rescue’ for small companies.

<sup>71</sup> Companies Act 71 Of 2008 s 133 provides for a general moratorium on all actions against the company. This means that once the business rescue proceedings have begun, no legal proceeding including any enforcement action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced subject to the exceptions provided in paragraphs *a-f*.

<sup>72</sup> P Kloppers ‘Judicial management– A corporate rescue mechanism in need of reform?’ (1999) 3 *Stell LR* 417 at 430.

<sup>73</sup> A Loubser op cit note 3 at 44.

<sup>74</sup> P Kloppers op cit note 72 at 428.

<sup>75</sup> *Ibid*.

aim of judicial management i.e. rescuing the business because at such time it might have been too late to turn the business around<sup>76</sup>. This greatly undermined the process.

Judicial management applied only to companies (see chapter 4.5) and not to other business form like partnerships and trusts. Although it was stated in *Rustomjee v Rustomjee (pty) Ltd*<sup>77</sup> that judicial management was not suitable for small private companies, the court found differently in *Tobacco auctions ltd v Aw Hamilton (pvt) ltd*<sup>78</sup> and stated that there is no reason as to why it should not apply to small private companies. Goldin J<sup>79</sup> was of the view that the size of the company is only a factor that should be taken into account when deciding whether to grant the judicial management order and is not in itself decisive. Notwithstanding this decision, judicial management remained confined to the business forms discussed above.

Under the Companies Act 1973, judicial management placed a lot of emphasis on the protection of creditor interests<sup>80</sup> and less on the saving of the company or its business. This further entrenched the status of judicial management as an extra-ordinary procedure that should be available only to large companies. This, in addition to the fact that it was perceived as an infringement on the rights of creditors<sup>81</sup>, contributed to the further demise of judicial management.

### 3.2: Social context:

These reasons relate to norms of the society as they existed at the time judicial management came into law. While these norms changed over the years, because a foundation had been laid initially, it became difficult for judicial management to succeed. It is accepted that for a corporate rescue model to be successful, a debtor friendly system of insolvency must be in place.<sup>82</sup> This however, was not the case in South Africa at the time as the Companies Act of 1973 was creditor-centric.<sup>83</sup>

The courts viewed judicial management as an extraordinary remedy. This was strange as there was no indication that this should have been the case.<sup>84</sup> The requirements for

<sup>76</sup> P Kloppers (2004) 'Judicial management reform – steps to initiate a business rescue' (2001) 13 *SA Merc LJ* 358 at 375.

<sup>77</sup> *Rustomjee v Rustomjee (pty) Ltd* 1960 (2) SA 101(D) at 107.

<sup>78</sup> *Tobacco Auctions Ltd v AW Hamilton (Pvt) Ltd* 1966 2 SA 500 (R) at 503.

<sup>79</sup> *Ibid.*

<sup>80</sup> Companies Act 1973 s 434(1).

<sup>81</sup> *Ibid.*

<sup>82</sup> R Bradstreet 'The Leak in the Chapter 6 lifeboat: Inadequate Regulation of Business Rescue Practitioners may adversely affect lenders' willingness and growth of the economy' (2010) 22 *SA Merc LJ* 195 at 198. The author explains that a 'debtor-friendly' insolvency system gives the management a chance to stay in place and contribute to saving the company.

<sup>83</sup> *Ibid* at 197 A creditor oriented model places the needs of creditors as a priority. Re-payment of what is owed to them is the focus of such a system and they have the most control in the process.

<sup>84</sup> P Kloppers op cit note 72 at 426.

a judicial management order lay in the Companies Act 1973 s 427 and presumably if they were satisfied, the court would grant the order. This however, was not what happened. In addition, creditors have the right to apply for liquidation and avoid anything to do with the more uncertain procedure of judicial management, which at the time, they presumably knew very little about.<sup>85</sup>

The disregard for judicial management could further have been perpetuated by banks (usually the biggest creditors). A major creditor usually has the majority vote in deciding whether to go the judicial management or liquidation route. Banks are often ruthless when reclaiming their loans even in cases where there is no actual but only commercial insolvency, liquidation is often their preferred route.<sup>86</sup> This could have entrenched judicial management's position as a second choice to affected persons seeking repayment of money owed to them.

There was a large use of liquidators as judicial managers.<sup>87</sup> This developed due to the close association judicial management had with liquidation as seen in the fact that the former was included in the chapter on winding up in the 1926 act. A liquidator's role is to sell the business for as much as he can get. The role of a judicial manager on the other hand is to save the business and possibly revive it. There was thus a difference in the core function of each officer. Using liquidators as judicial managers was counter-productive to the goals of judicial management.<sup>88</sup> It is no surprise that liquidators were used seeing that there were no stringent regulations with regard to the qualifications of judicial managers.<sup>89</sup> An exception was the requirement that only persons who were not the company's auditor, or were not precluded from becoming liquidators in terms of the Companies Act 1973 could be appointed as judicial managers.<sup>90</sup>

Judicial management greatly affected the credit worthiness of the company and this was still felt even after the order had been cancelled.<sup>91</sup> This would inhibit the company from trading optimally and reduce its chances of becoming a successful concern.<sup>92</sup>

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<sup>85</sup> DA Burdette 'An effective Business rescue model for South Africa (Part 1)' (2004) 16 *SA Merc LJ* 241 at 248.

<sup>86</sup> P Kloppers op cit note 72 at 427.

<sup>87</sup> DA Burdette *A framework for corporate insolvency law reform in South Africa* (2002) LLD, University of Pretoria at 349.

<sup>88</sup> AH Olver op cit note 70 at 86.

<sup>89</sup> Loubser op cit note 1 at 44.

<sup>90</sup> Companies Act 1973 s 428(b)(i)

<sup>91</sup> Cilliers and Benade *Corporate Law* op cit note 30 at 475.

<sup>92</sup> G. Mutsa op cit note 69 at 19.

The problems created by 'phoenix companies' could have contributed to the demise of judicial management. The expression is meant to describe a situation where soon after liquidation of one company, another springs up. The new company will often have the same management and staff of the recently liquidated one. The new company to a certain end enjoyed the good will of the liquidated one and as a new separate company, was not burdened by its liabilities. With such a framework in place, it is no wonder that judicial management was not popular.<sup>93</sup>

Judicial management went through an evolution from its introduction in the Companies Act 1926 up to its most recent form in the Companies Act 1973. As such, a lot of the cases were decided under out dated provisions of the previous acts. The courts however continued to rely on these cases for authority although they were 'decided on differently worded provisions'. In addition, the social perceptions of bankruptcy and corporate rescue prevailing at the time the cases were decided were substantially different and this further made reliance on these cases inappropriate.<sup>94</sup>

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<sup>93</sup> P Kloppers op cit note 72 at 431.

<sup>94</sup> A Loubser op cit note 3 at 162.

#### Chapter 4: Business Rescue as a Solution:

Chapters one to three serve as an exposition of the law relating to judicial management; its history, development, use and finally its repeal. Judicial management has been replaced by chapter 6 of the Companies Act 71 of 2008(hereafter Companies Act 2008). Although judicial management is regarded as having been a failure, it served as a basis on which corporate rescue law could evolve and to that end (judicial management) has been useful.

Business rescue became available for use by companies on May 11 2011 when the Companies Act 2008 came into law.<sup>95</sup> Although it is still early days, available data gives us a picture of the public's response to judicial management's successor.

In performing its function, one of the roles of the Companies and Intellectual Properties Commission (CIPC)<sup>96</sup> is to receive and record notices by companies that they are going in to business rescue. Between May 2011 and the end of the Companies and Intellectual Properties Commission's financial year of 2013 there were a total of 915 notices to begin business rescue that were filed nationwide. Of this number, 57 were invalid/discarded.<sup>97</sup>

These figures can be compared to those of judicial management. With regard to judicial management statistics, Olver has this to say;

'No official statistics relating to judicial management are kept in South Africa. All of the cases are subject to the supervision of the Master of the Supreme court of the Provincial or local division in which the company which [had] been placed in judicial management [had] its registered office.'<sup>98</sup>

At the time, there were six Masters' offices, namely Bloemfontein, Cape Town, Grahamstown, Kimberly, Pietermaritzburg and Pretoria. Cumulatively, between 1948 and 1978, there were a total of 1208 applications for judicial management. This number includes both successful and unsuccessful applications.<sup>99</sup>

In conclusion, in a 20 year time-frame, there were only 60 applications for judicial management on average annually. This is to be compared to a staggering 305 applications on average annually, since business rescue came into use. This could be due to the less onerous

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<sup>95</sup>Government Gazette (550) No. 9526 of 26 April 2011.

<sup>96</sup>The Companies and Intellectual Properties Commission was established by s 185 of the Companies Act 2008. It is an independent juristic person and has jurisdiction throughout the republic. Its main objectives are to register companies, maintain accurate and up to date information about companies, promote the education and awareness of companies and promote compliance with the companies Act 2008 as well as enforce it.

<sup>97</sup> Annual report of the Companies and Intellectual Properties Commission 2012/2013(2013) at par 6.3.2.

<sup>98</sup> AH Olver *Judicial management in South Africa vol 2: statistics* PHD (UCT) (1980) 1-3.

<sup>99</sup> Ibid.

requirements for the granting of a business rescue order created by the Companies Act 2008.<sup>100</sup> It could also be due to the fact that courts no longer treat business rescue as an extraordinary remedy to be granted in limited circumstances. This change in attitude (see chapter 3.2) suggests that the parties involved (creditors, companies, the courts) are more familiar with corporate rescue now than they were in the past and have a better idea on how best it is to be utilised. The above statistics on judicial management have a starting date that was 25 years (1948) after the first promulgation of judicial management in the Companies Act of 1923 vis those of business rescue that are dated from the very day the Companies Act 2008 came into use (May 11 2008). The reason for this is probably that data on judicial management applications in its inaugural years was negligible and not documented. Notwithstanding this fact, business rescue still displayed a higher usage rate.

The headings to follow address how business rescue attempts to address the challenges encountered by judicial management.

#### 4.1: Heavy reliance on the courts.

In a bid to make business rescue a more viable option to financially distressed companies<sup>101</sup> as compared to judicial management, the legislature simplified the commencement process. Two specific avenues are available. The one involves an application to court by affected persons<sup>102</sup> and the other is through a resolution by the board of the company.<sup>103</sup> The latter makes it possible for the company itself to decide when to start the procedure. This makes sense as it is the company that is in the best position (as opposed to the court under judicial management) to decide when this action should be taken. By allowing the board to initiate business rescue, the legislature has reduced the role of the court which in turn has reduced the costs associated with corporate rescue<sup>104</sup> and presumably made it more accessible to small companies.

#### 4.2: Automatic moratorium:

One of the consequences of a business rescue order is the moratorium.<sup>105</sup> Unlike, under judicial management, here it is automatic and does not rest on the court exercising its discretion. This means that all legal proceedings against the company are halted thereby providing the necessary breathing space to the company to organize its affairs and possibly save the company. The moratorium is vital to the success of a business rescue. This becomes

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<sup>100</sup> Companies Act 2008 s 129.

<sup>101</sup> Companies Act 2008 s 128.

<sup>102</sup> Companies Act 2008 s 131.

<sup>103</sup> Companies Act 2008 s 129.

<sup>104</sup> G Mutsa op cit note 69 at 24.

<sup>105</sup> Companies Act 2008 s133.

evident if we look at the phenomenon of informal creditor workouts between a company and its creditors. These are often unsuccessful because the creditors are not bound and can apply for liquidation at a later stage if they so decide.<sup>106</sup> If a moratorium came into play once these agreements were in place, it might increase their success.

#### 4.3: Formal Business rescue plan:

Under business rescue, the business rescue practitioner is required to make a formal plan for the rescue of the business.<sup>107</sup> The act requires the plan to have three sections i.e. a background, proposals and assumptions and conditions.<sup>108</sup> The plan must be presented to creditors and other stake-holders for consideration. The plan must contain all information reasonably required to facilitate affected persons in deciding whether or not to adopt it.<sup>109</sup> The plan ensures that at the least, the practitioner is performing his role by attempting to achieve the goals of business rescue. It is a way of monitoring his progress. The absence of the requirement for a formal business rescue plan was often cited as one of the shortfalls of judicial management.<sup>110</sup>

#### 4.4: Requirements for granting the business rescue order:

The Companies Act 1973 s 427(1) required a company not to be able to pay its debts before an order for judicial management could be granted. As explained above (chapter 3.1), the result was that companies often applied to court when they were already insolvent making it difficult to achieve the goals of judicial management. On the other hand, it is conceivable that if they applied early enough (prior to insolvency) they would not comply with the requirements of s 427(1). The new act solves this problem by requiring that the company must be financially distressed and that there appears to be a reasonable prospect of rescuing the business.<sup>111</sup> (Very simply, the company will be able to apply for business rescue before it has become insolvent). Furthermore, affected<sup>112</sup> persons may approach the court to

<sup>106</sup> DA Burdette op cit note 85 at 252. Under a workout large financial institutions come together to provide financial assistance to ailing companies.

<sup>107</sup> Companies Act 2008 s 150.

<sup>108</sup> Companies Act 2008 s 150(2).

<sup>109</sup> Companies Act 2008 s 133.

<sup>110</sup> A Loubser op cit note 3 at 44.

<sup>111</sup> Companies Act 2008 s 129(1), financially distressed is defined in 128(f). It means that

- i) It appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months; or
- ii) It appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months.

<sup>112</sup> An affected person is defined in s128(1) as-

- i) A shareholder or creditor of the company;
- ii) Any registered trade union representing employees of the company; and
- iii) If any of the employees of the company are not represented by a registered trade union, each of those employees or their respective representatives

grant a business rescue order if the company does not voluntarily do so.<sup>113</sup> This seeks to curtail the problem of the company not timeously applying for a business rescue order or doing so too late.

#### 4.5: Business forms to which business rescue applies:

One of the major criticisms of judicial management was that it was only accessible to companies and close corporations (if they converted to companies). Other business forms like business trusts and partnerships were excluded from the scope of its operation. Unfortunately, the new act does not address this issue. Business rescue continues to apply to companies and close corporations only, the latter having the option to convert into companies if they so choose.<sup>114</sup> Business trusts and partnerships are left with the option of informal work-out<sup>115</sup> with creditors. In this regard, business rescue is not that different from the judicial management.

#### 4.6: New corporate law philosophy:

In recent times the attitude towards bankruptcy has changed. It is now accepted that bankruptcy is a risk of entrepreneurship and as such failing businesses should not be punished but be assisted to get back on their feet.<sup>116</sup> The new model seeks to balance the interests all stake-holders and not those of creditors in isolation. For business rescue to flourish, this would be the preferred approach. The act further elicits this point of view in s 7(k). It reads as follows:

##### **‘7 Purposes of the Act**

The purposes of this act are to—

(k) provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders;...

Hopefully this change in attitude towards bankruptcy will see companies make more use of the corporate rescue avenues available in chapter 6. It is possible that over time, when the stigma created by judicial management has dissipated, creditors just might stop regarding business rescue an extra-ordinary method to obtain payment of their debts and start to look at it as a viable and realistic option capable of serving their needs.

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<sup>113</sup> Companies Act 2008 s 131.

<sup>114</sup> Companies Act 2008, sch 1.

<sup>115</sup> This is where an indebted company negotiates a settlement with creditors without the participation of the court.

<sup>116</sup> G Mutsa op cit note 69 at 2.

#### 4.7: Qualifications of business rescue practitioner:

The 1973 act did not prescribe minimum qualifications for judicial managers. This created the awkward situation where liquidators were often used as judicial managers which was counter-productive to the whole process of judicial management (see chapter 3.2, paragraph 3).

The new act goes a long way in attempting to resolve this problem of the past. Section 138 read with Companies Regulations 2011 reg.126 sets out in detail the requirements that must be complied with before one is appointed or accredited as a business rescue practitioner. While the requirements do not preclude liquidators from being appointed, Regulation 126(4) (b) states that the CIPC<sup>117</sup> must be satisfied that a potential business rescue practitioner has sufficient education and experience to enable him perform the functions of a business rescue practitioner. The CIPC<sup>118</sup> is charged with licensing practitioners and may withdraw or suspend such license in the prescribed manner.<sup>119</sup> To ensure that the commission does not abuse its regulatory power, the minister<sup>120</sup> may make regulations and procedures that the former must follow when carrying out its licensing function.

Due to the fact that these provisions are relatively new, the CIPC<sup>121</sup> is cautious in the issuing of licenses to business rescue practitioners. This is seen in the fact that between 2011 and 2013, only 142 business practitioners were granted licenses.<sup>122</sup> This number could increase in the future but is dependent on factors like how well the said officers perform their role.

#### 4.8: The problem created by phoenix companies:

As explained in chapter 3.2, judicial management was employed to a lesser extent because directors had the option of jumping ship. After running a company aground, it would be liquidated and another formed in its place to carry out the same business, under the stewardship of the same directors. The new act helps to curb this problem. It prescribes in detail the duties of directors, the standard of conduct expected from them and imposes penalties for the contravention thereof. Section 76(2)(ii) for instance provides that a director must not knowingly cause harm to the company and s 77 outlines the liability of directors for breach of their duties or if they cause loss to the company. The penalties are quite dire and

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<sup>117</sup> Companies Act 2008 s 185.

<sup>118</sup> Ibid.

<sup>119</sup> Companies Act 2008 s 138(2).

<sup>120</sup> Ibid.

<sup>121</sup> Companies Act 2008 s 185.

<sup>122</sup> Annual report of the companies and intellectual properties commission 2012/2013(2013) at par 6.3.2

far-reaching. One could be barred from being a director or placed under probation<sup>123</sup> and even incur personal liability for loss and or damages suffered by the company<sup>124</sup> It is expected that with this in place, directors will exercise more diligence in the performance of their roles.

#### 4.9: Repeal of the old act:

The Companies Act 1973 was amended several times during its subsistence. Judicial management alone went through three major amendments. The result was piece-meal legislation which led to a lot of uncertainty. There has since been a complete repeal of the said Act which has been replaced by a new one, which is modelled to ‘...serve the needs of a modern South African economy’.<sup>125</sup> The more unified statute, a result of an extensive drafting and consultation process, seeks to keep South Africa abreast with worldwide developments in corporate law and in line with better practise jurisdictions like the United Kingdom, the United States of America, Canada, etc. This, all with the intention of creating an investor friendly environment that will contribute to the growth of South Africa’s economy.

In particular, the newly drafted business rescue procedures in chapter 6 do not merely pick up from where judicial management left off. The former adds to and develops the law based on the latter’s failures, case law and the experiences that have been had.

Other parts of the Companies Act 2008 shall contribute to the success of business rescue. The concise codification of directors’ duties and the de-criminalisation of company law compared to the Companies Act 1973 are likely to improve the diligence of those engaged in the running of companies.<sup>126</sup> The overseeing role of the CIPC will also contribute towards the success of business rescue in so far as it regulates the licensing of business rescue practitioners. All this taken into account, one could suggest that the repeal of the Companies Act of 1973 was a necessary and a progressive step.

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<sup>123</sup> Companies Act 2008 s 162.

<sup>124</sup> Companies Act 2008 s 77.

<sup>125</sup> Department of Trade and Industry ‘South African Company Law for the 21<sup>st</sup> Century: Guidelines for Corporate Law Reform’ GN 1183 of 23 June 2004.

<sup>126</sup> P Sutherland ‘The State of company law in South Africa’ (2012) 1 *STELL LR* 157 at 176. The author observes that the Companies Act 1973 contained several criminal consequences for directors who contravened the Act. This proved to be highly ineffective as enforcement was hardly carried out. In the end, these provisions became superfluous.

## Chapter 5

### Conclusion:

The failure of judicial management can be attributed to several factors. Some of these factors are those mentioned in chapter three. That being said, chapter three does not purport to be an exhaustive list of factors and many more will and can be advanced.

It should further be noted that the grouping of these reasons according to the headings as I have placed them under is for the purpose of this paper only does not mean to suggest that the reasons for the failure of judicial management will always appear in this format.

The bulk of the reasons for the demise of judicial management (according to chapter 3) relate to short-comings in the legislation. This is unsurprising when we keep in mind the numerous numbers of times the Companies Act 1973 was amended thereby creating patch-work legislation (see paragraph 4.9). The strength of legislation is greatly determined by how well it is drafted and how appropriate it is to the needs of the population and to a certain end this was lacking in the judicial management provisions. For the most part, business rescue attempts to solve the problems of the past but only time will determine its (business rescue's) success.

The other grouping of reasons (the social context) pre-supposes that judicial management failed because of the prevailing social context i.e. the courts and creditors attitude towards failing businesses and insolvency as a larger concept. A change in perception would no doubt promote the success of a business rescue regime. This could happen over time but the Government would have to intervene (through a body like the CIPC) with seminars and workshops where information about business rescue is disseminated. A debtor-friendly insolvency system<sup>127</sup> would also add to the success of such an initiative.

For business rescue to work, the public must believe in the system as this was not the case with judicial management.<sup>128</sup> The legislator, through business rescue has acknowledged the short-comings of judicial management and has attempted to build a system devoid of those mistakes. Due to the several failures that judicial management experienced, and the legislature being keen to steer clear of them, it is possible that business rescue will prosper. Unfortunately however, laws are not effective merely because the legislature wishes them to be so but due to a combination of several factors.

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<sup>127</sup>R Bradstreet op cit note 82.

<sup>128</sup>G Mutsa op cit note 69 at 46.

While it may seem like the sky is the limit for business rescue (seeing that judicial management failed), there is a down-side to being the successor of judicial management. Due the lack of faith in the previous system, currently, informal work-outs and insolvency are still the preferred options for financially distressed companies.<sup>129</sup> As it stands, we will only be able to determine the success of business rescue retrospectively.

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<sup>129</sup>Ibid at 46.

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