SOUTH AFRICA

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1.0 INTRODUCTION AND OVERVIEW

1.1. Historical Background of South African Insolvency Law

An ordinance adopted in Amsterdam, Holland, in 1777 is regarded as the basis of much of the subsequent South African insolvency law. An important Cape insolvency ordinance (Ordinance 64 of 1829) was based upon English procedure, although it still contained a great deal of the Dutch practice. This ordinance was the first insolvency act in South Africa with detailed provisions like we are familiar with today. Ordinance 64 of 1829 was re-enacted with minor additions and modifications as Cape Ordinance 6 of 1843. This Ordinance was adopted by the other provinces with minor alterations.

The Insolvency Act 32 of 1916 repealed the existing statutes in the provinces and introduced a uniform act for the whole of South Africa. This act did not drastically amend the existing insolvency procedure. Its wording was nevertheless closer to that of the present Insolvency Act 24 of 1936 than to the preceding ordinances. The Insolvency Amendment Act 29 of 1926 made important amendments to the Insolvency Act of 1916.

1.2. Present Insolvency Act

The present Insolvency Act 24 of 1936 repealed the 1916 Act but did not amend it drastically. The following amendments are significant, however. The Master of the High Court (a public official who supervises, *inter alia*, the administration of insolvent estates), and no longer the court itself, appoints provisional trustees. Interrogations before the court or a commissioner were abolished. The Insolvency Act 24 of 1936 has been amended more than twenty times, but without any drastic changes. The South African insolvency law does not differ much in principle from the Roman and Roman-Dutch law. The wording of the Insolvency Act 24 of 1936 often follows the Insolvency Act 32 of 1916 verbatim. The wording is sometimes similar to provisions in English statutes, for example, section 157 of the Insolvency Act 24 of 1936 and section 147 of the Bankruptcy Act of 1914 (formal defects), section 8(a) of the Insolvency Act and section 1(d) of the Bankruptcy Act (one of the acts of insolvency), and section 64(5) of the Insolvency Act and section 25(l) of the Bankruptcy Act (interrogations). There was nevertheless no wholesale reception of English law principles that differed essentially from Roman-Dutch law.

The Act, although in the nature of a code, is not a complete statement of the law of insolvency and does not interfere with the common law of insolvency where the latter is not inconsistent with the provisions of the Act. The sources of the common law are Roman, Roman-Dutch law, and the judgments of the courts. Some provisions in other statutes also apply to insolvency, such as the Long-Term Insurance Act 52 of 1998 and the Alienation of Land Act 68 of 1981.

1.3. History of Legislation for Companies

The Cape Joint Stock Companies Limited Liability Act of 1861 was the first company legislation in South Africa. It was an almost verbatim adoption of the English Joint Stock Companies Act of 1844 and the Limited Liability Act of 1855. The English statutes also served as a precedent in Natal, the Transvaal, and the Orange Free State. The previous principal act, the Companies Act 46 of 1926, was based on the Transvaal Companies Act 31 of 1909, which was in turn based on the English Companies (Consolidation) Act of 1908. Important amendments to the Companies Act in England were followed by commissions of inquiry and legislation in South Africa. The Companies Act 61 of 1973 marks a divergence between English and South African company law. This parting of the ways has been accentuated by England's involvement in the harmonization of the company laws of Member States of the EU.[1]

1.4. Legislation for the Winding Up of Companies

The provisions for the winding up of companies in South Africa have not changed drastically over the years. The Insolvency Act 24 of 1936 applies, insofar as it is applicable in the winding-up of a company unable to pay its debts, with respect to any matter not specially provided for in the Companies Act. Where the Companies Act specially provides for winding-up, the provisions often differ from the provisions of the Insolvency Act, albeit in form only and not with respect to substance or principle. Substantial differences between the provisions that apply to insolvency and those that apply to the winding-up of companies can usually be explained in terms of material differences between individuals and companies. The difference in origin of the Insolvency Act and the Companies Act clearly also played a role. The law regulating the winding-up of a close corporation is contained substantially in the Close Corporation Act 69 of 1984, as amended, and the Companies Act. (Close corporations are less formalized corporate entities than companies.)

1.5. General Features of Sequestration and Winding Up in South Africa

The process to declare a person's estate bankrupt is known as sequestration. Sequestration orders relating to individuals and liquidation (winding up) orders relating to corporations are made pursuant to orders granted by the various High Courts having jurisdiction. The overall supervision and regulation of bankruptcy is in the hands of a government official known as the Master of the High Court (the "Master"), who has offices in six principle cities in the country (steps are under way to open further offices). Insolvency practitioners act as liquidators of corporations and trustees of individual bankrupt estates (these persons will be referred to hereinafter as "insolvency administrators").

The sequestration of the estate of an insolvent individual divests the insolvent of his estate and vests it in the Master and in the trustee upon his appointment. Sequestration stays civil proceedings and proceedings to execute judgments given against the insolvent. (Insolvency Act section 20(l)). The trustee is under a general duty to sell the assets (Insolvency Act section 82(l)). The proceeds from the assets subject to secured claims are applied to pay certain costs and the secured claims (Insolvency Act section 95); and assets not subject to secured claims are applied to pay the cost of sequestration, statutory preferences, and ordinary creditors who have proved their claims against the estate (Insolvency Act sections 96 to 103). The trustee, or a creditor acting in the name of the trustee, may institute proceedings to set aside dispositions without value, voidable preferences, undue preferences, and collusive dealings before sequestration (Insolvency Act sections 26 and 29 to 32). With the exception of a few statutory preferences, a creditor (including a secured creditor) can only pursue his claim if he proves it against the insolvent estate.

An insolvent individual may apply to the court for an order for his rehabilitation (Insolvency Act section 124). Any insolvent not declared to be rehabilitated by the court within ten years from the date of sequestration is deemed to be rehabilitated after the expiry of that period, unless a court orders otherwise prior to the expiration of the ten years (Insolvency Act section 127A). The rehabilitation does not affect the estate, which is vested in the trustee and has not yet been distributed, but rehabilitation generally puts an end to sequestration, discharges all debts of the insolvent that were owed before sequestration, and relieves the insolvent of every disability resulting from the sequestration (Insolvency Act section 128). Debts due at the date of sequestration (except debts arising from fraud) are discharged by rehabilitation (Insolvency Act section 128(1)(b)).

Provision is made for acceptance of an offer of composition by 75 percent of proven creditors in value and in number (Insolvency Act section 119). Such a composition is binding on all the ordinary (concurrent) creditors and may provide for the re-vesting of assets in the insolvent. The composition binds secured and preferred creditors with their consent.

In any winding-up of a company by the court, all the property of the company is deemed to be in the custody and under the control of the Master and, upon the appointment of a liquidator, under the control of the liquidator. (section 361 of the Companies Act 61 of 1973). The winding-up suspends legal proceedings against the company; and attachments or executions after commencement of the winding-up are void (Companies Act section 359). The liquidator must recover and take possession of all the assets and property of the company and apply them to satisfy the costs of winding-up and the claims of creditors (Companies Act section 391). The law relating to the insolvency of individuals applies to the winding-up of companies insofar as it is applicable (Companies Act section 339), in particular to the use of assets to pay creditors and the costs of winding-up (Companies Act section 342), the proving of claims, the position of secured creditors (Companies Act section 366), and the setting aside of voidable dispositions and undue preferences (Companies Act section 340). The court may declare any person who was knowingly a party to any business of the company being carried on recklessly or with intent to defraud creditors of the company to be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct (Companies Act section 424).

The court may order meetings of the creditors, or a class of creditors, to consider a compromise or arrangement. If it is agreed to by a majority in number representing 75 percent in value of the creditors (or class of creditors) and is sanctioned by the court, the compromise or arrangement will be binding on all creditors (or class of creditors) and the liquidator. (Companies Act Section 311.)

1.6. Number of Cases Handled Annually

The figures in Table 1 below, supplied by the Master, are for insolvencies (individual and corporate) and judicial management in the six offices of the Master for the years 2001 to 2003. Figures for compromises in terms of section 311 of the Companies Act 61 of 1973 are not available, but according to the Master in Pretoria, these figures are, like judicial management, very low. For more comprehensive statistics visit www.statssa.gov.za and from there you go to "Releases", then to "current releases of", and then to

"Statistics of Liquidations and Insolvencies".

Table 1. Insolvencies and judicial management during 2001 to 2003

		Pretoria	Kimberley	Grahams-town	Cape Town	Pieter-maritzburg	Bloem-fontein	Total
2001	**Individuals**	2,907	40	145	396	219	268	3,975
	Companies	2,027	38	135	734	408	148	3,490
	Judicial management	3	1	0	0	0	0	4
2002	**Individuals**	2,335	31	84	260	43	197	2,950
	Companies	3,212	16	92	500	472	132	4,424
	Judicial management	1	0	0	7	0	0	8
2003	**Individuals**	2,309	30	72	195	52	132	2,790
	Companies	2,522	22	75	466	407	46	3,538
	Judicial management	4	0	1	0	1	0	6
		15,320	178	604	2,558	1,602	923	21,185

The only available data on the time taken for liquidation proceedings is contained in a limited survey published in Working Paper 29 of the South African Law Commission, *Prerequisites for and Alternatives to Sequestration* (March 1989, Schedule 4).

Table 2. Time required to liquidate

TIME LAPSE FROM GRANTING OF FINAL ORDER TO CONFIRMATION OF FINAL ACCOUNT (*143 CASES*)					
Months	7-12	13-18	19-24	25-30	30+
Individuals	5.3%	47.4%	26.3%	13.1%	7.9%
Companies	14.9%	40.3%	20.9%	14.9%	9..0%
All cases	9.8%	44.0%	23.8%	14.0%	8.4%

The average length of time for rehabilitation – that is, for the completion of a scheme of arrangement in terms of section 311 of the Companies Act – is about three months. This is the average time required to formulate the scheme documents; apply to the court for leave to convene the necessary meetings of creditors, and if necessary, shareholders; then convene the meetings of creditors, including giving notice to creditors and shareholders of the meeting; and prepare and submit the statutory report in terms of section 311. Thereafter, if the scheme is accepted at the meetings, application must be made to the court to sanction the scheme and, if a liquidation order was granted, to set aside the order. Then, and only then, can the scheme be implemented by the receivers for the benefit of creditors. All this takes time.

1.7. Effectiveness of System and Main Problems

The lack of interest displayed by creditors in the administration of insolvent estates is well known in South Africa. One of the reasons for this indifference is that concurrent creditors seldom receive any benefit of substance from the insolvent estate. A report by the South African Law Commission recommended the repeal of many of the preferences in order to improve the position of concurrent creditors, but this has not been accepted by government.

There are complaints that the examination and confirmation of accounts and other interventions by the Master lead to delays. Moreover, there is a lack of confidence in some of the insolvency administrators and in the exercise of discretion by some of the Masters in appointing provisional insolvency practitioners. Both of these concerns are addressed in the report of the South African Law Commission. During March 2003, the Cabinet approved legislation based on the Commission's report, but legislation has not been tabled in Parliament. It will not be tabled before the elections in April 2004.

2.0 LEGAL FRAMEWORK

As appears from the historical background above, South African law derives from both the common and civil law systems.

The existing legislation was enacted in 1936 and amended several times, but not drastically. The South African Law Commission reviewed the insolvency law and, in February 2000, recommended a new Bill to replace the Insolvency Act 24 of 1936. The Standing Advisory Committee on Company Law has proposed unified insolvency legislation to deal with all entities (individuals, companies, close corporations and other entities), much of this based on the recommendations for individuals by the Commission. A bill based on these recommendations has not been tabled in Parliament.

The primary feature of the law is the principle of *concursus creditorum* (simultaneity of creditors' claims), i.e., the debtor's position is crystallized as at the date of sequestration and assets are safeguarded for transmission to creditors. Provision is also made for a fresh start by an individual debtor through the discharge of debts.

2.1. Director and Officer Liability

There are provisions to curb wrongful trading. Sections 423 to 426 of the Companies Act 61 of 1973 specifies offences and provides for personal liability of delinquent directors and others. Section 424 (1) sets out the following:

> When it appears, whether it be in a winding-up, judicial management or otherwise, that any business of the company was or is being carried on recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court may, on the application of the Master, the liquidator, the judicial manager, any creditor or member or contributory of the company, declare that any person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court may direct.

The Supreme Court of Appeal has stated that if a company conducts business and incurs debts when, in opinion of reasonable businessmen, there is no reasonable prospect of creditors receiving payment when due, it is proper to draw the inference that the business was carried on recklessly. The director's honest belief as to prospects of timely payment is not in itself determinative of whether he was reckless. Such belief is irrelevant if a reasonable person with business sense in the same circumstances would not have held that belief.[2]

Section 424(3) provides that, without prejudice to any other criminal liability incurred, where any business of a company is carried on recklessly or with such intent or for such purpose as is mentioned in subsection (1), every person who knowingly participated in the conduct of the business in the aforesaid manner is guilty of an offence.

3.0 INSOLVENCY AND LIQUIDATION

3.1. Liquidation

Generally, the High Court has exclusive jurisdiction in all matters of insolvency. However, shareholders can initiate the liquidation of a company, other than an external company, by passing a resolution to place the company in liquidation and to appoint a liquidator. A company may be wound up voluntarily for any reason, even if it is quite solvent. The High Court may, in certain circumstances, set aside a voluntary liquidation. A creditor may successfully place a debtor in liquidation by applying to the High Court for a winding-up order. In the case of close corporations, the Magistrate Court also has jurisdiction to issue winding-up orders. By far, the most businesses are liquidated by initiating winding-up proceedings. Insolvency administrators are elected by creditors at duly convened meetings of creditors and are subject to overall supervision by the Master. Such persons will invariably consult and keep creditors advised of matters relating to the insolvency.

3.2. Rehabilitation Briefly

The rehabilitation procedures for corporate entities are somewhat outmoded. Details are given in the discussion of reorganization in section 5.0 below. Rescue proceedings are in the process of being reviewed.

3.3. Eligibility

The insolvency process applies to all forms of enterprises or corporate entities. Special rules apply with respect to certain entities: chapter VI of the Long-Term Insurance Act 52 of 1998; section 29 of the Pension Funds Act 24 of 1956; section 35 of the Friendly Societies Act 25 of 1956; section 53 of the Medical Schemes Act 131 of 2002; sections 15 and 35 of the Collective Investment Schemes Control Act 45 of 2002; chapter X of the Co-Operatives Act 91 of 1981; section 33 of the Financial Markets Control Act 55 of 1989; section 68 of the Banks Act 94 of 1990; chapter VIII of the Mutual Banks Act 124 of 1993; and sections 59 and 60 of the Labor Relations Act 85 of 1995. Section 34 of the Administration of Estates Act 66 of 1965 provides for the administration of insolvent deceased estates.

3.4. Access Criteria

In the case of individuals, actual insolvency or an "act of insolvency" in terms of section 8 of the Insolvency Act 24 of 1936 must be proved, for instance, by written notice that the debtor is unable to pay debts, or insufficient assets to sell in execution for payment of judgment. For corporations, section 345(1) of the Companies Act 61 of 1973 provides as follows:

> (1) A company or body corporate shall be deemed to be unable to pay its debts if -
> `
>
> (a) a creditor, by cession or otherwise, to whom the company is indebted in a sum not less than one hundred rand then due -
>
> (i) has served on the company, by leaving the same at its registered office, a demand requiring the company to pay the sum so due; or
>
> (ii) in the case of any body corporate not incorporated under this Act, has served such demand by leaving it at its main office or delivering it to the secretary or some director, manager or principal officer of such body corporate or in such other manner as the Court may direct,
>
> and the company or body corporate has for three weeks thereafter neglected to pay the sum, or to secure or compound for it to the reasonable satisfaction of the creditor; or
>
> (b) any process issued on a judgment, decree or order of any court in favour of a creditor of the company is returned by the sheriff or the messenger with an endorsement that he has not found sufficient disposable property to satisfy the judgment, decree or order or that any disposable property found did not upon sale satisfy such process; or
>
> (c) it is proved to the satisfaction of the Court that the company is unable to pay its debts.

3.5. The Bankruptcy Estate

The estate includes all rights, including rights obtained after the commencement of the case and subject to exclusions with respect to bedding and necessary clothing, insurance, pension rights, etc, in the case of individual debtors. The estate vests in the trustee or comes under the control of the liquidator after appointment. The trustee or liquidator must take immediate steps to preserve, protect, and collect assets of value and may abandon assets without value.

3.6. Commencement Effects

Individual actions are stayed by the commencement of proceedings until the insolvency administrator is appointed. Thereafter, actions may be continued subject to time scales and special permissions. The sale of assets in execution is also stayed. Payment of debts after commencement of proceedings does not discharge the debt. The collateral of secured creditors is dealt with by the insolvency administrator, who applies the proceeds, after payment of certain costs, in payment of secured creditors. Assets subject to financial leases do not form part of the insolvent estate. If a composition in terms of section 311 of the Companies Act is contemplated, a stay is obtained by applying for the winding up of the company. The winding up order is discharged when the court sanctions the composition. A judicial management order also grants a moratorium.

3.7. Role of Management

In both liquidation proceedings and rescue proceedings, existing management is usually replaced by court-appointed officials or insolvency administrators appointed by the Master. In some cases, aspects of management may be left to existing management on behalf of the official managers.

3.8. Role of the Creditors' Committee

South African law does not provide for creditors' committees. Creditors have the right to vote on the administration of liquidation or rescue proceedings at meetings. Votes by creditors play an important role when the insolvency administrators are appointed. Nothing prohibits informal committees, and major creditors sometimes form a committee in large liquidation proceedings. Liquidation and distribution accounts are advertised for inspection by creditors and other interested parties before distribution.

The insolvency administrator is not an officer of the court, but acts subject to supervision of the Master.

3.9. Contractual Obligations

As a general rule, the insolvency administrator has a right to enforce or cancel contracts. Special rules exist for some contracts, for instance leases, land, and assets dealt with on financial markets. When enforcement is elected, either expressly or by insisting on performance by the other party, the insolvency administrator must perform in full. In practice, contracts are usually not enforced after insolvency. There are special rules to ignore set-off in cases of insolvency (except cases involving financial markets).

3.10. Fraudulent and Preferential Transactions

Provision is made for setting aside fraudulent transactions, undue preferences, and other transactions without value. Insolvency is usually a requirement. The setting aside of preferential dispositions is limited to a period of six months. There is no time limitation for cases of fraud or intention to prefer some creditors above others. In cases of disposition without value, provision is made for presumed insolvency within two years.

3.11. Treatment of Stakeholders' Interests and Priorities

The rights of recognized secured creditors are respected after insolvency. The security is, however, administered and realized by the insolvency administrator and the creditor must prove his claim against the insolvent estate. This claim is payable from the proceeds of the collateral after deduction of administration costs. The creditor is entitled to interest if the proceeds of the collateral and income are sufficient to pay capital and costs. Reservation of title creditors are regarded as secured creditors, but financial lease creditors are owners outside the insolvency administration. The South African Law Commission recommended that financial lease creditors should be included in the same way as other secured creditors.

There is a long list of statutory preferences by unsecured creditors. The South African Law Commission has proposed scrapping these preferences, except for those preferring employees for salary and related claims, arrears maintenance claims, and claims under bonds over movables that do not afford security. However, the government did not accept these recommendations. In addition to preferences for employees, employees and unions are entitled to be informed about insolvency applications and about financial difficulties that may reasonably result in insolvency.

3.12. Features Pertaining to Corporate Rehabilitation

The South African system for corporate rehabilitation still follows the traditional forms.

Judicial management has a high threshold for entry (*viz*., reasonable prospects to become a successful concern). The procedure is only used a few times each year. Existing management is not allowed to continue operating the enterprise, except with the special agreement of the judicial manager. Provision is made for independent administration. Payments are suspended with respect to all creditors. The duration of the suspension must be a reasonable time. Provision is made, with the consent of existing creditors, for priority of funding. Annual financial statements are required, but there are no detailed rules for advancement of the process and control. Directors are, in theory, required to attend meetings. Creditors have voting rights, but there is no provision for a committee of creditors.

There is no provision for a plan as such or objective analysis in the case of judicial management. The court-supervised reorganizations make provision for approval of proposals. These reorganizations and judicial management are discussed in some detail below.

4.0 REORGANISATIONS

Most large business undertakings in South Africa are owned by companies and not by natural persons. The effective rescue of such companies invariably takes place by way of reorganizations in terms of judicial proceedings. A moratorium is often obtained by applying for winding up, judicial management, or a stay of actions. The winding-up or judicial management order or stay of actions is set aside when the court sanctions the proposals.

These proceedings are typically commenced by outside investors, occasionally by creditors, and in some cases, by shareholders of the company or the company itself. The Companies Act applies to such reorganizations. The well-known and tested American Chapter 11 rescue procedure, with the debtor remaining in possession, is unknown in South African law. So, too, is the English bankruptcy concept of a “floating charge”. Modern rescue provisions for South Africa are under investigation.

At common law, a composition as a means of reorganizing a company is binding only on a person who accepts it. The need arises both for a procedure whereby the company can negotiate with its creditors and shareholders collectively, and for machinery to enable the company to bind all of them to a reorganization scheme agreed to and decided upon by a majority. Sections 311, 312 and 313 of the Companies Act provide such procedures. More particularly, section 311, provides for the reorganization of companies by way of compromises or arrangements, particularly between the company and its creditors (or class of creditors), or by the company and its shareholders (or class of shareholders), or by the company and any combination of its creditors and shareholders, or class of them.

Three procedural steps are required. First, where a compromise or arrangement is proposed, a person with *locus standi* under the section must bring an application to the High Court, to obtain the authority and directions of the court for summoning the meetings of creditors or shareholders concerned. Second, if the court grants the order, meetings are summoned and held in order to obtain the agreement of the required majority of creditors or shareholders. Third, if the proposal is agreed to by the requisite majority or majorities, the sanction of the court must be sought for the arrangement. In terms of the arrangement, a "receiver" is usually appointed whose function, subject to the overriding control of the court, is to implement the arrangement.

Any person can propose an arrangement, but only a person with the necessary *locus standi* can make the application to the court for the summoning of meetings to consider the arrangement. The court has wide judicial discretion to decide whether or not to grant leave to summon the meetings for consideration of the arrangement. In exercising that discretion, the court will demand to be satisfied that there is a reasonable probability that the requisite majority might approve of the arrangement. However, the court will not permit meetings to be summoned where the proposed arrangement would operate unjustly against anyone.

The meetings must be summoned in accordance with the directions of the order of the court. The notice convening the meetings must be accompanied by a statement explaining the terms of the arrangement and its effect. The notice must also include a copy of the court order summoning the meetings and a proxy form enabling a creditor or shareholder who is unable to attend the meeting personally, to appoint a representative.

The arrangement may be quite broad in character. To be binding, it must (i) be agreed to by a majority of creditors (or class of creditors) voting in person or by proxy, and (ii) sanctioned by the court. A majority of creditors (or class of creditors) is defined as either a majority in number representing three-fourths of the value of the debt or as a majority representing three-fourths of the votes exercisable by the shareholders or class of shareholders. Once the court sanctions the approved agreement, it becomes binding on all creditors (or on all creditors in the class), on the shareholders (or all shareholders in the class), and on the company (or on the liquidator if the company is being wound up, or on the judicial manager if the company is subject to a judicial management order). Therefore, before it sanctions the arrangement, the court must satisfy itself that all of the statutory requirements and terms of the court order have been complied with.

The court's function is not merely to register the decision of the statutory majority. As a general principle, the court will regard the creditors of the company as being the best judges of what is in their commercial interests. Where the majority has, on the basis of sufficient information at their disposal, reached their conclusion in favor of the arrangement honestly and without reference to irrelevant considerations, the court will respect the wishes of the majority and not overly concern itself with the commercial wisdom of the arrangement. Implicit in the exercise of the court's statutory discretion to sanction an arrangement is the power to impose suitable conditions to secure effective implementation of its terms. No arrangement affects the liability of any person who is a surety for the company. Debts arising after the arrangement are not covered by it unless expressly provided.

In many cases, the arrangement provides for the appointment of a receiver whose function is to receive payment and to make pro rata distributions to creditors according to the terms of the arrangement. The receiver is the administrative manager of the arrangement, with responsibility for interpreting and implementing its terms. The receiver is often vested with plenary powers regarding the admission and rejection of claims. The arrangement binds the receiver to distribute the estate's funds by way of dividends to those creditors whose claims he has admitted. A distribution account prepared by the receiver pursuant to the arrangement must be available for inspection by interested parties.

5.0 REHABILITATIONS

5.1. Out-of-Court Rehabilitation

South Africa has no formal non-bankruptcy workouts or restructuring guidelines. Such matters are addressed on an ad hoc basis. The out-of-court arrangements are only binding on consenting parties. Where this arrangement is not possible, it becomes necessary to resort to the courts and procedures discussed in the section above on reorganizations.

5.2. Nature of Rehabilitation Negotiations

In both out-of-court and in-court workouts dealing with debt renegotiation, the parties are mostly concerned with debt compromising, with or without debt rescheduling. They also frequently engage in and allow debt forgiveness and write-off, with or without debt-to-equity conversions.

5.3. Recognition of Formal Rehabilitation

The process of formal rehabilitation through insolvency is recognized and effectively implemented, provided it was done according to the terms of section 311 of the Companies Act as set out above. Unfortunately, this process, as the law now stands, is somewhat cumbersome.

Once a formal rehabilitation has been sanctioned by the court, it acquires the status of an order of court. The results of such rehabilitations are invariably good.

5.4. Judicial Management

Although most countries have enacted their business rescue regimes within the last twenty years, South Africa's dates back to as long as 77 years, when legislation introducing judicial management was incorporated in the South African Companies Act of 1926. In theory, judicial management is a most effective rescue tool. However, it has not been used often in recent times: according to the Master, it has only been employed once or twice each year.

Judicial management is aimed at obtaining a moratorium and preventing a company from being placed in liquidation in a situation where, by proper management or proper conservation of its resources, the company would be able to meet its obligations and avoid any occasion for winding-up, to become a successful concern. Judicial management takes place pursuant to an order of court and upon the application of the company itself, one or more of its creditors, or by one or more of its shareholders, or jointly by any one or all of these parties. The overriding consideration, which will influence the court in deciding whether or not to grant a judicial management order, is whether the applicant can demonstrate that the company has a reasonable prospect of being able to surmount its present difficulties and thrive.

When a company is placed under judicial management, its directors are divested of their powers and a judicial manager is appointed. The judicial manager acts under the direction of the court. His job is to run the company's business in the manner he deems most economic and beneficial to the interests of the shareholders and creditors of the company. The judicial management order usually provides for a moratorium so as to give the company a breathing space. Any funds received by the judicial manager must be applied in payment of the costs of the judicial management and the claims of post-judicial-management creditors. Only then, insofar as circumstances permit, can payment be made toward the claims of *pre*-judicial-management creditors.

If the judicial management is successful, the judicial manager must apply to court for the cancellation of the judicial management order and for directions concerning resumption of the management and affairs of the company. Conversely, if it appears to the judicial manager that the judicial management is unsuccessful, he must apply to court for the cancellation of the judicial management order and for an order to wind up the company.

6.0 INSTITUTIONAL FRAMEWORK

There are no specialized insolvency courts or judges; the High Court has jurisdiction. A high level commission recently rejected submissions proposing that insolvency courts should be instituted, although many in the insolvency administration business believe that such specialized courts would be desirable. The independence of the courts is guaranteed by the Constitution.

Liquidation procedures are carried out under the supervision of a civil servant – the Master – through six offices spread across the country (steps are under way to open further offices). There have been allegations of corruption and a number of Master's office officials have been suspended pending further investigations.

7.0 REGULATORY FRAMEWORK

There is no statutory body for the supervision of insolvency administrators, but many of the administrators are attorneys or accountants, who are subject to the rules of discipline of their statutory professional bodies. The Association of Insolvency Practitioners of Southern Africa ("AIPSA") is a voluntary association that represents a large percentage of insolvency administrators. AIPSA has a code of conduct and disciplines members for breaches of the rules. The Association for the Advancement of Black Insolvency Practitioners (AABIP) was formed in 1999. AIPSA and AABIP formed a joint body, the Insolvency Practitioners of South Africa (IPSSA) and this body is striving to gain recognition as a statutory body.

A person with interests opposed to the general interests of creditors, a person related to the insolvent within certain degrees, an auditor of a company, etc, is disqualified from being appointed as an insolvency administrator.

In terms of the proposals by the South African Law Commission, a person who is not a member of a professional body recognized by the Minister responsible for Justice will not qualify to be elected or appointed as an insolvency administrator. The Minister may, according to the proposals, from time to time publish the name of a recognized professional body if it appears to the Minister that such body regulates the practice of a profession, and maintains and enforces rules for ensuring that a member is a fit and proper person to be appointed as insolvency administrator and meets acceptable requirements for education and practical experience and training.

Insolvency administrators lodge insurance bonds in an amount set by the Master, to guarantee the proper performance of their duties. Liquidation and distribution accounts are scrutinized by the Master and advertised for inspection. The Master refuses to appoint insolvency administrators who fail to fulfill their duties, and can apply for court orders to force the administrators to comply with legal requirements.

7.1. Secured Credit (Non-Bankruptcy Procedures)

7.1.1. Secured Credit in Real Property

Debts owed to banks and other lending institutions and debts owed in relation to immovable property are typically secured by mortgage bonds over real estate. The documents that evidence the aforementioned transactions are the mortgage bonds themselves, a formal notarial bond document, or suretyship documents from third parties. Mortgage bonds are registered in the office of the Registrar of Deeds as are notarial bonds over movables, while other forms of security are recorded in written documents that are retained by the parties.

There is no limitation on foreigners taking security.

Secured claims are enforced in liquidation by the creditor submitting his claim to the insolvency administrator, who thereafter acts to realize the secured property and pay the net proceeds over to the secured creditor.

7.1.2. Security in Personal Property

The types of business debts that are typically secured by personal property are commercial loans and trade debts. The principal documents evidencing such a transaction are notarial general bonds over movables or cessions of receivables. Notarial general bonds over movables are registered in the office of the Registrar of Deeds. No specific formalities are required to perfect cessions of book debts and there is no central register for cessions.

As a general rule, for a party to have a lien or pledge, he must be in possession of the debtor's property. This does not apply, however, to a lien arising under the Merchant Shipping Act 57 of 1951, where special provisions apply. Similarly special provisions apply to security for financing the purchase of aircraft by South Africans.

There are no limitations on foreigners taking security.

The enforcement and realization of secured claims with respect to movables or personal property is dealt with in substantially the same way as the enforcement and realization of secured claims over immovable or real property, the rules for which are described above.

7.2. Unsecured Claims

Other than self-help, which is frowned upon, there are no "non-judicial collection techniques" available in South Africa.

Prior to obtaining a judgment for the recovery of the debt, an unsecured creditor has limited access to the property of the debtor. The available remedies include:

- Mareva-types of injunctions;
- The arrest of an absconding debtor;
- A sequestration order.

Once judgment is obtained, unsecured creditors may have the debtor's property attached and sold at a judicial sale in execution.

No special procedures apply to foreign creditors. They have full access to the domestic courts on domestic claims, subject only to the provision of security for costs. South African courts also enforce foreign judgments in appropriate cases.

The length of time to obtain a judgment and the cost of obtaining it will depend upon the amount of the debt and the particular court in which proceedings are taken for enforcement. Much will depend upon whether the claim is disputed or not. In the case of undisputed claims, judgment by default may be obtained in a very short time, while litigation in the case of disputed claims may take anything from one to three years or longer from the date the summons is issued until the date a judgment is obtained.

8.0 PRIMARY NEEDS TO IMPROVE THE SYSTEM OF CREDIT AND INSOLVENCY PROCEDURES

The credit system does not seem to require improvement of a material nature. One aspect worth considering is a central register relating to the cession of receivables.

In my view, the major problems experienced with insolvency administration relate to the lack of professionalism of some insolvency administrators and some insolvency regulators. The recommendations in the report of the South African Law Commission will address most of the shortcomings with procedures and practical problems, but not the question of dedicated insolvency judges or insolvency judges in the existing commercial courts. There is, of course, room for debate regarding many policy decisions reflected in the report of the Commission.

The models for company rehabilitation are in need of a review, but steps are under way to develop modern business rescue provisions for South Africa.

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[1] *See* H.S. Cilliers, M.L. Benade, D.H. Botha, M.H. Oosthuizen & E. M. de la Rey, *Corporate Law* 1987, at 16-19).
[2] *Philotex (Pty) Ltd and Others v. Snyman* 1998 (2) SA 138 (SCA).
[3] I am grateful to Mr. Laurence Pereira of the law firm of Vorster & Pereira, a member of the International Insolvency Institute and former chairperson of the Association of Insolvency Practitioners of Southern Africa, for his assistance, in particular with regard to company rehabilitation or workouts and non-bankruptcy matters. Some of the text above was taken verbatim from material supplied by him.