INSOL INTERNATIONAL

FOUNDATION CERTIFICATE IN INTERNATIONAL INSOLVENCY LAW

Module 7D Guidance Text

South Africa

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INSOL INTERNATIONAL
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CONTENTS

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1. INTRODUCTION TO INTERNATIONAL INSOLVENCY LAW IN SOUTH AFRICA

Welcome to **Module 7D**, dealing with the insolvency system of **South Africa**. This Module is one of the elective module choices for the Foundation Certificate. The purpose of this guidance text is to provide:

- a general overview, including the background and history, of South Africa's insolvency laws;
- a relatively detailed overview of South Africa's insolvency system, dealing with both corporate and consumer insolvency; and
- a relatively detailed overview of the rules relating to international insolvency and how they are dealt with in the context of South Africa.

This guidance text is all that is required to be consulted for the completion of the assessment for this module. You are not required to look beyond the guidance text for the answers to the assessment questions, although bonus marks will be awarded if you do refer to materials beyond this guidance text when submitting your assessment.

Please note that the formal assessment for this module must be submitted by **11 pm (23:00) BST (GMT +1) on 31 July 2022**. Please consult the web pages for the Foundation Certificate in International Insolvency Law for both the assessment and the instructions for submitting the assessment. Please note that no extensions for the submission of assessments beyond 31 July 2022 will be considered.

For general guidance on what is expected of you on the course generally, and more specifically in respect of each module, please consult the course handbook which you will find on the web pages for the Foundation Certificate in International Insolvency Law on the INSOL International website.

2. AIMS AND OUTCOMES OF THIS MODULE

After having completed this module you should have a good understanding of the following aspects of insolvency law in South Africa:

- the background and historical development of South African insolvency law;
- the various pieces of primary and secondary legislation governing South African insolvency law;
- the operation of the primary legislation in regard to liquidation and corporate rescue;
- the operation of the primary and other legislation in regard to corporate debtors;

- the rules of international insolvency law as they apply in South Africa;
- the rules relating to the recognition of foreign judgments in South Africa.

After having completed this module you should be able to:

- answer direct and multiple-choice type questions relating to the content of this module;
- be able to write an essay on any aspect of South African insolvency law; and
- be able to answer questions based on a set of facts relating to South African insolvency law.

Throughout the guidance text you will find a number of self-assessment questions. These are designed to assist you in ensuring that you understand the work being covered as you progress through text. In order to assist you further, the suggested answers to the self-assessment questions are provided to you in **Appendix A**.

3. AN INTRODUCTION TO SOUTH AFRICA

South Africa is the southernmost country in Africa with a coastline spanning 2,798 kilometres (1,739 miles). Due to its location, the Dutch East India Company (*Vereenigde Oost-Indische Compagnie*) established a refreshment outpost at the Cape of Good Hope in 1652 to provide its sailors with fresh food and water *en route* to the east. Following the establishment of the outpost, the Cape of Good Hope was under Dutch rule and later under English rule (and eventually the whole country with its borders as it is today was under English rule).[1] The Cape of Good Hope would eventually become Cape Town, which is currently South Africa's legislative capital where Parliament is situated. South Africa remained under English rule until 1961, when it also withdrew from the Commonwealth (but subsequently re-joined the Commonwealth in 1994 after the end of *apartheid*). South Africa's population is diverse in culture and ethnicity and the country has eleven official languages.

South Africa is a democracy with a constitutional dispensation. The Constitution 1996[2] provides for a separation of powers between the executive, legislative and judicial authority, with all law or conduct subject to the supremacy of the Constitution.[3] South Africa has an uncodified common law legal system based on Roman-Dutch law, with an influence of English law.

During 2017 South Africa had a gross domestic product (GDP) of US$ 765.6 billion and the economy grew by 1.7%.[4] South Africa is a middle-income emerging market economy with an abundant supply of natural resources; well-developed financial, legal, communications, energy,

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1 The influence of both Dutch and English law played an important role in South Africa's insolvency regime. See the discussion in para 4.1 below.
2 Hereafter the "Constitution".
3 See Constitution, ss 43(a), 85(1), 165(1) and (2).
4 http://www.statssa.gov.za/?p=10985.

and transport sectors; and a stock exchange that is Africa's largest and among the top 20 in the world.[5]

4. LEGAL SYSTEM AND INSTITUTIONAL FRAMEWORK

4.1 Legal System

South Africa has an uncodified common law legal system based on Roman-Dutch law, with a strong influence of English law.[6] Although South African law has not been codified, the common law (in so far as legislation has not abolished or altered a particular rule thereof), as well as precedents set by the high courts, are primary sources of law.[7] In terms of the Constitution, legislation may be tested by the courts in order to establish the constitutionality thereof, as the Constitution is the supreme law of the land.

Insolvency law in South Africa has been influenced by Roman law, Dutch law and English law. The Roman principle of *cessio bonorum* (the surrendering of an estate to one's creditors) in its main form was introduced into Dutch law probably around the end of the fifteenth century.[8] A *cessio* was initially administered under the supervision of a local magistrate but, during the eighteenth century, chambers were established, known as *Desolate Boedelkamers*, which had the function, *inter alia*, of administering insolvent estates. When the Dutch occupied the Cape of Good Hope in 1652, they brought their laws with them and Roman-Dutch law was applied in South Africa. The Ordinance of Amsterdam, passed in 1777, formed the basis of much of the South African law of insolvency.[9] A *Desolate Boedelkamer* was also established in the Cape of Good Hope in 1803, but was later abolished in 1818 and a sequestrator was appointed instead.[10] In 1806 the Cape of Good Hope was seized by the British and the first complete insolvency legislation was Ordinance 64 of 1829, which was introduced in the Cape under English influence.[11] In the geographical area where the current South Africa lies, four republics were formed – the Cape Colony, and subsequently Transvaal, Natal and the Orange Free State. The Cape Ordinance 6 of 1843 repealed Ordinance 64 of 1829 and it also served as the basis for insolvency legislation in the other three republics (Transvaal, Natal and the Orange Free State). In 1910 the four republics became the Union of South Africa[12] and in 1916 the first uniform Insolvency Act 32 of 1916 was introduced. This Act was amended by Amendment Act 29 of 1926 and was eventually replaced by the Insolvency Act 24 of 1936[13] which is still in force

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5 https://www.cia.gov/the-world-factbook/countries/south-africa/.

6 The courts also look at English law for guidance in the absence of authority in Roman-Dutch law. See Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 16 in this regard.

7 Other primary sources include legislation, indigenous law and customary law.

8 Sharrock, Van der Linde and Smith, *Hockly's Insolvency Law* (9th edition, Juta 2012) 12. See also Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 6 to 9.

9 *Fairlie v Raubenheimer* 1935 AD 135 146.

10 Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 10.

11 This new ordinance did retain certain Roman-Dutch procedures, some of which were however abolished at later stage. See Nagel *et al*, *Commercial Law* (5th edition, LexisNexis 2015) 504.

12 The Union of South Africa became the Republic of South Africa in 1961, as it is still known today.

13 Hereafter the "Insolvency Act".

today.[14] Where the Insolvency Act is silent on any point, recourse must be had to the common law.[15]

The Insolvency Act provides for personal bankruptcy and even though it is the principal source of insolvency law, the Companies Act 61 of 1973,[16] the Companies Act 71 of 2008[17] and the Close Corporations Act 69 of 1984 also contain provisions for the liquidation of companies and close corporations.[18] The Insolvency Act is applicable to corporate liquidation proceedings, as section 339 of the Companies Act 1973 provides that "the provisions relating to law of insolvency shall, in so far as they are applicable, be applied *mutatis mutandis* in respect of any matter not specifically provided for in this Act." South Africa's corporate rescue system, called business rescue, is also provided for in the Companies Act 2008.[19] There is no unified statute providing for personal bankruptcy, corporate insolvency and corporate rescue.

4.2 Institutional Framework

Section 165 of the Constitution provides that "[t]he courts are independent and subject only to the Constitution and the law…". Section 166 of the Constitution establishes the courts in the following order of hierarchy:

(a) the Constitutional Court;

(b) the Supreme Court of Appeal;

(c) the High Court of South Africa and any high court of appeal that may be established by an Act of Parliament to hear appeals from any court of a status similar to the High Court of South Africa;

(d) the Magistrate's Court; and

(e) any other court established or recognised in terms of an Act of Parliament, including any court of a status similar to either the High Court of South Africa or the Magistrates' Courts.

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14 Nagel *et al*, *Commercial Law* (5th edition, LexisNexis 2015) 504.

15 Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 10. Also see *Fairlie v Raubenheimer* 1935 AD 135 146.

16 Hereafter the "Companies Act 1973".

17 Hereafter the "Companies Act 2008". See the discussion in para 6.3 below as to why both the Companies Act 1973 (which has largely been repealed) and the Companies Act 2008, are applicable to liquidation proceedings.

18 Personal bankruptcy is discussed in para 6.2 below, and corporate liquidation is discussed in para 6.3 below.

19 See the discussion in para 6.5 below.

Jurisdiction in insolvency related matters is vested in the High Court,[20] but a Magistrate's Court with jurisdiction[21] may hear certain matters relating to the insolvent estate.[22] There is however no ongoing supervision by an insolvency court. Proceedings are opened in the High Court, but these courts hear other types of matters as well. Further court involvement is limited to a specific dispute referred to it.[23]

Creditors are not allowed to enforce claims outside the insolvency proceedings,[24] and court involvement in this regard is limited and confined to disputes referred to court.[25]

South Africa does not have a dedicated insolvency regulator allocated only for that purpose. The state does however to some extent "regulate" the profession of insolvency officeholders (trustees in personal bankruptcy and liquidators in corporate liquidation) by way of many legislative obligations placed on the Master of the High Court[26] as well as by providing the Master with discretionary powers relating to appointments.[27] Some of the Master's further functions include regulatory oversight over insolvency officeholders;[28] issuing directions on specific issues;[29] exercising custody over all documents relating to insolvent estates;[30] determining disputes relating to the proof of claims[31] and considering objections against, directing the amendment of, and confirming estate accounts.[32] In terms of section 158(2) of the Insolvency Act[33] the legislator has recently attempted to regulate the insolvency profession by

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20 See the definition of "court" in s 2 of the Insolvency Act in this regard. The definition refers to the "Supreme Court", which has subsequently become the High Court.

21 The Magistrates' Court Act 32 of 1944 imposes certain limits on the jurisdiction of the Magistrate's Courts relating to person, amount and the matter in question.

22 A Magistrate's Court may hear matters relating to, amongst others, the setting aside of voidable dispositions (see the discussion in paragraph 6.2 below) and offences under the Insolvency Act.

23 Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Richter (eds) *Commencement of Insolvency Proceedings* (Oxford University Press 2012) 521 556. The High Court also hears applications in cross-border insolvency matters.

24 Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn, Richter and Tirado (eds) *Ranking and Priority of Creditors* (Oxford University Press 2016) 441 446. The full procedure on proving of claims by creditors is discussed in paragraph 6.2 below.

25 *Ibid*.

26 The Master of the High Court is a creature of statute and is appointed in terms of s 4 of the Administration of Estates Act 66 of 1965 for each local division of the High Court. The High Courts fall under the government Department of Justice and Constitutional Development. The Master plays an important role in sequestration and liquidation proceedings (see the discussions of these procedures in paragraphs 6.2 and 6.3 below).

27 See inter alia s 18 of the Insolvency Act and s 368 Companies Act 1973 in this regard. See also Calitz and Burdette, "The appointment of insolvency practitioners in South Africa: Time for change?" 2006 *Tydskrif vir die Suid-Afrikaanse Reg* (TSAR) 721 in this regard. For a more in-depth discussion on the duties of the Master, see Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 28 to 31.

28 Insolvency Act, ss 18 and 57.

29 See, eg, Companies Act 1973, s 386.

30 Insolvency Act, s 154(1).

31 *Idem*, s 45(3).

32 *Idem*, ss 111 and 112.

33 Section 158(2) of the Insolvency Act provides that "[t]he Minister may determine policy for the appointment of a *curator bonis*, trustee, provisional trustee or co-trustee by the Master in order to promote consistency, fairness, transparency and the achievement of equality for persons previously disadvantaged by unfair discrimination."

providing for an appointment policy[34] to govern the appointment of insolvency practitioners.[35] The High Court declared the policy invalid for being inconsistent with the Constitution.[36] Subsequently the Supreme Court of Appeal found the policy unlawful and invalid[37] and thereafter the Constitutional Court confirmed that the policy was indeed unconstitutional.[38] The Constitutional Court held that the policy was, *inter alia*, irrational and unlawfully fettered the discretion of the Master to appoint an insolvency practitioner.[39]

A business rescue practitioner (the officeholder in corporate rescue)[40] needs to be a member in good standing of a legal, accounting or business management profession accredited by the Companies and Intellectual Properties Commission,[41] or the business rescue practitioner must be licensed as such by the CIPC. In terms of a recent practice note[42] the CIPC will not license a business rescue practitioner as such without the practitioner being a member of good standing of a legal, accounting or business management profession that has been accredited by the CIPC.[43] The CIPC does not have authority to be involved in the corporate rescue process.[44]

Although there is no government insolvency regulator, there is a voluntary professional regulatory body called SARIPA (South African Restructuring and Insolvency Practitioners

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34 *Government Gazette* 37287 (7 Feb 2014). The policy may be viewed at https://www.gov.za/sites/default/files/gcis_document/201409/37287gon77.pdf. See also Burdette and Calitz, "4:3:2:1... Fair distribution of appointments or countdown to catastrophe? South Africa's ministerial policy for the appointment of liquidators under the spotlight" 3 (2015) *Nottingham Insolvency and Business Law eJournal* (*NIBLeJ*) 437.

35 The term "insolvency practitioner" includes both the trustee of an insolvent estate (see the discussion in para 6.2 below) and the liquidator of a company (see the discussion in para 6.3 below).

36 *The South African Restructuring and Insolvency Practitioners Association v The Minister of Justice and Constitutional Development* (4314/2014) [2014] WCC (13 January 2015).

37 *Minister of Justice and Constitutional Development and Another v South African Restructuring and Insolvency Practitioners Association and Others* 2017 (3) SA 95 (SCA) (2 December 2016).

38 *Minister of Justice and Constitutional Development and Another v South African Restructuring and Insolvency Practitioners Association and Others* [2018] ZACC 20.

39 Specifically see paras 27 to 58 of the judgment in this regard.

40 See also Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Richter (eds) *Commencement of Insolvency Proceedings* (Oxford University Press 2012) 521 556 to 557 relating to insolvency regulation.

41 Hereafter the "CIPC". CIPC falls under the Department of Trade and Industry. Also see s 138 of the Companies Act 2008 for the qualifications of business rescue practitioners, read with reg 126(1) of the 2011 Companies Regulations.

42 CIPC, Practice note 1 of 2018. Available at http://www.cipc.co.za/files/7015/3796/0325/Practice_Note_1_of_2018_Qualifications_of_Practitioners.pdf.

43 CIPC, Notice 14 of 2018. For a list of all such accredited professional bodies, visit www.cipc.co.za/files/6315/2231/0262/List_of_Accredited_Bodies.pdf. These professional bodies have been accredited under the provisions of s 138(1)(a) read with reg 126 of the 2011 Companies Regulations. Accreditation and licensing is not without ambiguity as, among others, there are disparities between the Afrikaans (one of South Africa's eleven official languages) version and the English version (which was adopted by Parliament) of the Companies Act 2008; and the CIPC seems to have attempted to amend the Companies Act 2008 and its regulations simply by issuing a notice. See *Samons v Turnaround Management Association South Africa* (*NPC*) *and Another* [2019] JOL 40870 (GJ) and Kunst, Boraine and Burdette, *Meskin's Insolvency Law* (LexisNexis loose-leaf Edition 2019) para 18.14.2.

44 The CIPC is notified of certain aspects of the business rescue process such as the initiation of these proceedings; the appointment of the business rescue practitioner and the termination of these proceedings (Companies Act 2008, ss 129(3), 129(4)(a) and 132(2)(b) respectively). The CIPC exercises an administrative function and is not involved in any other aspects of the corporate rescue, such as the drafting or approval of the business rescue plan (which is discussed in para 6.5.7 below).

Association)[45] which is also a member organisation of INSOL International. SARIPA has over 650 members consisting of, *inter alia*, trustees, liquidators and business rescue practitioners. SARIPA has its own code of ethics and professional conduct that members must adhere to. SARIPA is also currently involved with the government in establishing a framework for statutory regulation. In this regard, SARIPA would like to see such regulation imposing that all practitioners must belong to a statutorily regulated body.[46]

Self-Assessment Exercise 1

Study the basic aspects dealt with in the previous section.

Question 1

Write a short essay on the regulation of insolvency practitioners in South Africa.

For commentary and feedback on self-assessment exercise 1, please see APPENDIX A

5. SECURITY

The Insolvency Act defines "security" as follows:

> "…in relation to the claim of a creditor of an insolvent estate…property of that estate over which the creditor has a preferent right by virtue of any special mortgage, landlord's legal hypothec, pledge or right of retention".[47]

The Insolvency Act further defines "preference" as follows:

> "…in relation to any claim against an insolvent estate, means the right to payment of that claim out of the assets of the estate in preference to other claims, and "preferent" has a corresponding meaning".[48]

It is therefore clear from the definition of "security" that it relates to property of the estate, which means that only real security grants preference in terms of the Insolvency Act.

The Insolvency Act does not provide for a definition of "secured creditor", but it is clear that a secured creditor is a creditor who enjoys security for his claim.[49] Each form of security that provides preference (and thus making a creditor a secured creditor) will be discussed below.

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45 SARIPA is also one of the CIPC accredited professional bodies for business rescue practitioners. See note 43.
46 For more information, visit SARIPA's website at www.saripa.co.za.
47 Insolvency Act, s 2.
48 *Ibid*.
49 Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 432.

5.1 Real security

5.1.1 Special mortgage

The Insolvency Act provides that a "special mortgage" includes the following:

(a) a mortgage bond hypothecating any immovable property;

(b) a notarial mortgage bond hypothecating specially described movable property in terms of section 1 of the Security by Means of Movable Property Act 57 of 1993;[50] or

(c) a notarial mortgage bond hypothecating specially described movable property registered before 7 May 1993 in terms of section 1 of the Notarial Bonds (Natal) Act 18 of 1932.[51]

The following principles are applicable to the various types of special mortgages provided for in the Insolvency Act:

5.1.1.1 Mortgage bond

In order to constitute a right of security over immovable property it is necessary for a mortgage bond to be registered against the title deed of the property in the Deeds Office, which office is responsible for the registration, management and maintenance of the property registry in South Africa. The mortgage bond will specifically indicate the debt that the property is security for including the amount of debt secured. Ownership of immovable property specifically hypothecated may not be transferred without the bond being cancelled or the written consent of the mortgage bond holder (the secured creditor).[52]

5.1.1.2 Notarial mortgage bond

A notarial bond serves to bring about security in respect of movable property, either specially or in general.[53]

Special notarial bond

In order to constitute a right of security over movable property a notarial bond needs to be registered in the Deeds Office in terms of either section 1 of the Security by Means of Movable Property Act on or after 7 May 1993, or it should have been registered in terms of section 1 of the Notarial Bonds (Natal) Act prior to this date. A notarial bond registered in terms of the Security by Means of Movable Property Act hypothecates corporeal movable property specified and described in the bond in a manner that makes it readily recognisable.[54] The effect of the

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50 Hereafter the "Security by Means of Movable Property Act".

51 Hereafter the "Notarial Bonds (Natal) Act". See s 2 of the Insolvency Act for the definition of "special mortgage".

52 Deeds Registries Act, s 56(1).

53 Nagel *et al*, *Commercial Law* (5th edition, LexisNexis 2015) 418.

54 Security by Means of Movable Property Act, s 1(1). In *Ikea Trading Und Design AG v BOE Bank Ltd* 2005 (2) SA 7 (SCA), the court held that the expression "described in the bond in a manner which renders it easily recognizable"

registration of the bond at the Deeds Office is that the property is deemed to have been pledged[55] to the mortgagee (the secured creditor) as if it had been expressly pledged and delivered to the creditor.[56]

General notarial bond

A notarial bond may also be registered to hypothecate movable property generally.[57] Such movable property is described generally in the bond and registered in the Deeds Office.[58] In insolvency proceedings, this bond does not constitute a "special mortgage" in terms of section 2 of the Insolvency Act and the holder of such a bond is not a secured creditor.[59] The holder of such a bond does however have a preferent claim in terms of the Insolvency Act.[60]

5.1.2 Hypothecs

In terms of the Insolvency Act only a landlord's legal hypothec and a hypothec mentioned in section 84(1) of the act confers preference to a creditor against an insolvent estate.[61] A hypothec is created *ex lege* (by law) and the parties do not have to specifically agree to it in order for it to be constituted. There is also no registration requirement for the validity of a hypothec.

A landlord's legal hypothec is a common law right enjoyed by a landlord in respect of arrear rent over movable property brought into or upon the leased premises – and over all crops raised by the tenant thereon – and operates for as long as the rent is owing. A landlord may only make attachment of the property in terms of a court order, and it is thus necessary for the landlord to actually attach the assets on the property in order to obtain the rights under this hypothec.[62]

Section 84(1) of the Insolvency Act provides that if property was delivered to a debtor under a transaction that is an instalment agreement,[63] such a transaction is regarded on the sequestration of the debtor's estate as creating in favour of the creditor a hypothec over that property whereby the amount still outstanding under the transaction is secured. The trustee of such a debtor's insolvent estate must deliver the property that is subject to such instalment

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means that third parties can determine the identity of each asset which has been bonded without regard to extrinsic evidence (see specifically para 21 of the judgment).

55 See the discussion on pledge in para 5.1.3 below.

56 Security by Means of Movable Property Act, s 1(1).

57 Deeds Registries Act, s 102.

58 Nagel *et al*, *Commercial Law* (5th edition, LexisNexis 2015) 418.

59 Sharrock, *Business Transactions Law* (8th edition, Juta 2011) 757.

60 Insolvency Act, s 102. Under South African law creditors in insolvency proceedings may either be secured or unsecured. Unsecured creditors are further subdivided into preferent (preferential or priority) creditors and concurrent creditors and they rank in this order. Preferent (preferential or priority) claims are paid out of the free residue of the estate, which is that part of the estate which is not subject to the rights of secured creditors. Unlike many other jurisdictions, assets subject to the rights of secured creditors also form part of the estate and are dealt with by the trustee or liquidator. The proceeds of secured assets are ringfenced with the proceeds being paid to secured creditors after the payment of certain costs and expenses. See the discussion in paras 6.2 and 6.3 below regarding statutory preferent claims.

61 *Idem*, s 85(1).

62 Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 445 to 446.

63 National Credit Act 34 of 2005, s 1, definition of "instalment agreement".

agreement to the creditor (if required by the creditor) who is thereby deemed to hold the property as security for his claim.[64]

5.1.3 Pledge

A right of security over movable corporeal property may be created by the delivery of the property concerned to the creditor and the pledge remains effective for as long as the creditor remains in possession of the property.[65] The pledged object will remain in possession of the creditor until the debt has been satisfied.[66] A pledge is created by agreement between the debtor and the creditor and there is no registration requirement for its validity. Due to the requirement that the creditor must remain in possession of the pledged object, it does not serve much practical purpose in the commercial world.[67]

Movable incorporeal property may also be pledged by means of a cession made *in securitatem debiti* or "cession as security for a debt". This takes place where a personal right is ceded as security for the payment of a debt. Such personal right could include rights in respect of shares in a company, a right to payment in terms of a life insurance policy, the right to claim payment from debtors mentioned in an accounting book ("book debts") or the right of action under a negotiable instrument.[68] This form of security, as with pledge, is created by agreement between the debtor and the creditor and there is no registration requirement for its validity. The debtor and creditor should be clear in their agreement whether the cession is an out-and-out cession or whether the cession is in fact a pledge of a personal right, as the effect thereof is important upon sequestration of the debtor's estate. In an out-and-out cession, ownership of the right in action is transferred to the creditor (the cessionary), but with a pledge the ownership in the right remains with the debtor (the cedent) and the cessionary may only exercise the rights associated with the cession upon default of payment.[69] There is an important practical difference between an out-and-out cession and a pledge when the estate of the debtor in question is sequestrated.[70] If the cession is indeed a pledge, then the creditor becomes a secured creditor of the insolvent estate. In an instance where such a cession is an out-and-out cession, the creditor becomes the legal owner of the right and can realise the incorporeal property in his own name without heeding any insolvency proceedings. Due to the important practical difference between the two constructions of a cession in security, the courts have decided that in the absence of clear intention between the parties as to the construction intended, the pledge theory will apply.[71]

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64 Insolvency Act, s 84(1).

65 Sharrock, *Business Transactions Law* (8th edition, Juta 2011) 754.

66 Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 441.

67 *Idem*, at 442. Parties often rather agree to the registration of a special notarial bond over movable property, as in these circumstances the movable property in question remains in possession of the debtor and may be used by the debtor.

68 Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 443.

69 *Ibid*.

70 Sharrock *Business Transactions Law* (8th edition, Juta 2011) 758.

71 *O'Shea NO v Van Zyl and Others NNO* 2012 (1) SA (SCA) par 36. Also see *Retmil Financial Services (Pty) Ltd v Santam Life Insurance Company (Pty) Ltd and Others* [2013] 3 All SA 337 (WCC).

5.1.4 Right of retention

A right of retention, or a lien, arises where a person (the creditor or lienholder) acquires possession of another's property, movable or immovable, and expends money or labour on it, makes improvements to it, while it is in his possession. In these circumstances, the lienholder has the right to retain physical control of the property until compensated by the debtor.[72] A lien differs in principle from a hypothec in that actual possession by the creditor is an absolute prerequisite for the existence of the lien.[73] A lien is created *ex lege* (arises by operation of law) and the parties do not have to specifically agree to it. There is also no registration requirement for the validity of a lien.

5.2 Enforcement of security

Upon the granting of a sequestration order by the court, the estate of the insolvent vests in the Master. After the appointment of a trustee, the estate will vest in the trustee.[74] The estate that vests in the Master (and subsequently the trustee) consists of the insolvent's property, movable and immovable, including proceeds of property in the hands of the sheriff under a writ of attachment, owned by him at the date of sequestration and all property acquired by the insolvent or accruing to him during sequestration.[75] Other than is the case in most jurisdictions around the world, assets subject to security also fall into the insolvent estate; the trustee deals with these assets in the same way as other assets of the estate, except that the proceeds of these assets are ringfenced for payment to secured creditors subject to certain costs being deducted from the proceeds.

Creditors of the insolvent estate must prove a claim against the insolvent estate in order to receive any proceeds from the realisation of estate assets.[76] When creditors hold security for their claims, they must provide details of the security they hold when proving their claims.

5.2.1 Movable property held as security

A secured creditor who holds movable property as security for this claim must inform the Master and the trustee (if a trustee has been appointed)[77] in writing of such before the second meeting of creditors.[78] In some instances the creditor may realise the movable property himself, but in other circumstances he may not.[79] In instances where the creditor may realise the property

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72 Sharrock *Business Transactions Law* (8th edition, Juta 2011) 774.

73 Sharrock, Van der Linde and Smith, *Hockly's Insolvency Law* (9th edition, Juta 2012) 185. Also see s 47 of the Insolvency Act discussed in para 5.2 below.

74 Insolvency Act, s 20(1)(a). See the discussion on the appointment of the trustee in para 6.2 below.

75 *Idem*, s 20(2)(a) and (b). Not all of the insolvent's assets vest in the trustee. See the discussion in para 6.2 below on exempt property.

76 Proof of claims is discussed in para 6.2 below.

77 Meetings in an insolvent estate and the appointment of a trustee discussed in para 6.2 below.

78 Insolvency Act, s 83(1).

79 *Idem*, s 83(2) and (3). Property that may be realised by the creditor consist of securities as defined in s 1(1) of the Financial Markets Act 19 of 2012, a bill of exchange or a financial instrument or a foreign financial instrument as defined in s 1(1) of the Financial Sector Regulation Act 9 of 2017. Any other property may not be sold by the creditor.

himself, he is still required to subsequently prove a claim against the insolvent in terms of section 44 of the Insolvency Act.[80] In instances where the creditor does not realise the property himself, he is required to deliver the property to the trustee, after which the creditor must still prove a claim against the insolvent estate.[81]

Even though possession by the creditor is of utmost importance for the validity of a landlord's legal hypothec and a right of retention, no creditor will lose such security by virtue of him delivering the asset to the trustee. The creditor is required to notify the trustee in writing of his rights and should further subsequently prove a claim against the insolvent estate.[82]

5.2.2 Immovable property held as security

A creditor with security over immovable property to secure his claim may not realise such immovable property himself. If such creditor has valued his security when proving his claim, the trustee may, if authorised by the creditors, within three months from the date of his appointment or from the date of the proof of the claim (whichever is the later) take over the immovable property at the value placed thereon by the creditor when his claim was proved. If the trustee does not within that period take over the said property he has to realise it for the benefit of all creditors whose claims are secured thereby, according to their respective rights.[83]

5.3 Personal security

Suretyship (guarantee) is a form of personal security and it is a contract between two parties in terms of which one party (the surety) undertakes to the other (the creditor) that he will discharge, wholly or in part, an obligation owed to the creditor by another person (the debtor) should the latter default in performing to the creditor.[84] As is clear from the discussion above,[85] suretyship does not provide preference in an insolvent estate and does not make such a creditor a secured creditor for purposes of the Insolvency Act.

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80 *Idem*, s 83(5). Where property held as security in favour of a secured creditor for obligations arising out of a master agreement as defined in s 35B(2) of the Insolvency Act (including eligible collateral in terms of the applicable standards made under the Financial Sector Regulation Act 9 of 2017, or the Financial Markets Act 19 of 2012) has been realised by the creditor, the creditor does not need to prove a claim.

81 *Idem*, s 83(6) and (7).

82 *Idem*, s 47.

83 *Idem*, s 83(11). See also Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 474.

84 Sharrock, *Business Transactions Law* (8th edition, Juta 2011) 761.

85 See paras 5 and 5.1 above.

Self-Assessment Exercise 2

Study the basic aspects dealt with in the previous section.

Question 1

Provide an overview of the various ways in which a creditor can be a secured creditor and enjoy preference in terms of the Insolvency Act.

For commentary and feedback on self-assessment exercise 2, please see APPENDIX A

6. INSOLVENCY SYSTEM

6.1 General

South African insolvency law is provided for in various pieces of legislation. Personal bankruptcy (sequestration) is provided for in the Insolvency Act; corporate liquidation is provided for in both the Companies Act 1973 and the Companies Act 2008 and corporate rescue (business rescue) is provided for in the Companies Act 2008. The Insolvency Act is further also applicable to corporate liquidation proceedings, as section 339 of the Companies Act 1973 provides that "the provisions relating to law of insolvency shall, in so far as they are applicable, be applied *mutatis mutandis* in respect of any matter not specifically provided for in this Act."

The South African insolvency system is essentially creditor-friendly, but this has been the subject of much recent scrutiny and criticism[86] and law reform in this regard has been suggested.[87]

The courts have very limited involvement in the management of insolvency proceedings. For personal bankruptcy, corporate liquidation and compulsory corporate rescue proceedings the High Court is required to grant an order to open such proceedings. Further court involvement is limited to disputes referred to it. The respective officeholders play an important role in the management of the proceedings throughout. Creditors are also involved in proceedings as they are afforded, amongst other things, voting rights; a choice in the election of the officeholder in certain instances; they attend meetings and provide instructions to the trustee

[86] See Roestoff and Boraine, "*Body Corporate Palm Lane v Masinge* 2013 JDR 2332 (GNP): Discretion and powers of the court in applications for sequestration" 2015 *De Jure* 206 to 226 and Boraine and Roestoff, "Revisiting the State of Consumer Insolvency in South Africa after Twenty Years: The Courts' Approach, International Guidelines and an Appeal for Urgent Law Reform" Part 1 2014 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg / Journal of Contemporary Roman-Dutch Law* (THRHR) 352 in this regard. See further Lesenyeho *Constitutionality of the Advantage to Creditors Requirement and a Comparative Investigation in Insolvency Law* (2017 dissertation University of Pretoria).

[87] See the discussion in para 9 below.

and liquidator on certain aspects.[88] In respect of corporate rescue proceedings, the creditors vote whether to approve the business rescue plan or not.[89]

6.2 Personal / consumer bankruptcy

6.2.1 Who a debtor is for the purposes of consumer insolvency

The Insolvency Act defines a "debtor" as follows:

> "…in connection with the sequestration of the debtor's estate, means a person or a partnership or the estate of a person or a partnership which is a debtor in the usual sense of the word, except a body corporate or a company or other association of persons which may be placed in liquidation under the laws relating to Companies."

It is thus clear that sequestration proceedings are applicable to all entities that are not companies or close corporations with juristic personality. The term "debtor" therefore embraces the following:

- a natural person;
- a partnership (even if all the members are juristic persons);[90]
- a deceased estate and an insolvent debtor incapable of managing his own affairs;[91]
- an external company that does not fall within the definition of "external company" in the Companies Act 1973;[92] and
- an entity or association of persons that is not a juristic person, such as a trust.[93]

6.2.2 Commencement of voluntary and compulsory bankruptcy proceedings

Sequestration proceedings may commence either by means of voluntary surrender[94] or compulsory sequestration.[95] Voluntary surrender entails an insolvent debtor approaching the court to accept the surrender of his estate for the benefit of his creditors, while under compulsory sequestration one or more creditors of the debtor will approach the court for the

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88 These aspects may include whether to assume or reject an executory contract and instructions as to the sale of assets of the insolvent estate. See the discussion in paras 6.2 and 6.3 below.

89 See the discussion in para 6.5 below.

90 *Commissioner, South African Revenue Service v Hawker Air Services (Pty) Ltd; Commissioner, South African Revenue Service v Hawker Aviation Partnership & others* 2006 (4) SA 292 (SCA).

91 Insolvency Act, s 3(1).

92 *Lawclaims (Pty) Ltd v Rea Shipping Co SA: Schiffscommerz Aussenhandels Betrieb der VVB Schiffbau intervening* 1979 (4) SA 745 (N) 751.

93 *Melville v Busane and another* 2012 (1) SA 233 (ECP).

94 Insolvency Act, s 3.

95 *Idem*, s 9.

sequestration of the debtor's estate. Sequestration may only take place after such an order has been granted by the High Court.[96]

There is no obligation to enter bankruptcy proceedings[97] and should an insolvent debtor choose to apply for voluntary sequestration the court still has a discretion as to whether to grant the order or not, even in instances where the debtor has complied with all of the relevant requirements and formalities.[98]

In relation to voluntary surrender there is no threshold for entering sequestration proceedings. The debtor must, however, be able to prove that (i) there will be sufficient free residue to cover the costs of sequestration; and (ii) that sequestration will be to the advantage of creditors.[99] "Free residue" is defined as "…that portion of the estate which is not subject to any right of preference by reason of any special mortgage, legal hypothec, pledge or right of retention". For the purpose of calculating the amount of free residue in an estate, the surplus in value of encumbered assets over the amount of the encumbrances must be taken into consideration.[100] The debtor must thus own sufficient property to meet the costs of sequestration, and a debtor without any assets (and only liabilities) may not surrender his estate.[101] For sequestration to be to the advantage of creditors it must "yield at the least, a not negligible dividend".[102] Various divisions of the High Court differ on what constitutes a sufficient or non-negligent dividend,[103] but in general an advantage to creditors will be present if there is a reasonable and not too remote prospect of some pecuniary benefit to creditors.[104]

In applying for the compulsory sequestration of a debtor's estate, a creditor must be able to prove that (i) he has a liquidated claim of at least ZAR 100, or if two or more creditors are applying they must have liquidated claims against the debtor amounting, in aggregate, to not less than ZAR 200;[105] and (ii) that there is reason to believe that the sequestration will be to the advantage of creditors.[106] A liquidated claim is a monetary claim, the amount of which is fixed

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96 In certain instances a court will grant an order for provisional sequestration before the final order is granted: Insolvency Act, s 10.

97 Section 3 of the Insolvency Act states that an insolvent debtor "may" petition the court for the acceptance of the surrender of the debtor's estate. Section 9 of the Insolvency Act also states that creditors "may" petition the court for the sequestration of a debtor's estate.

98 Insolvency Act, s 6(1). Factors that influence the discretion of the court may include a debtor's ulterior motive in applying for sequestration (*Naidoo & another v Matlala NO & others* 2012 (1) SA 143 (GNP)); the debtor's creditors are not pressing him for payment and are willing to give him time or accept payment in monthly instalments (*Ex parte Kruger* 1928 CPD 233); and the debtor's financial problems could be dealt with more appropriately under the National Credit Act 34 of 2005 (*Ex parte Ford and two similar cases* 2009 (3) SA 376 (WCC)). See the discussion on alternatives to formal bankruptcy below. See also Sharrock, Van der Linde and Smith, *Hockly's Insolvency Law* (9th edition, Juta 2012) 30.

99 *Idem*, s 6(1).

100 *Ex parte Van Heerden* 1923 CPD 279.

101 *Ex parte Collins* 1927 WLD 1972. An estate consisting only of liabilities may, however, be compulsorily sequestrated (*Miller v Janks* 1977 TPD 127).

102 *Trust Wholesalers and Woollens (Pty) Ltd v Mackan* 1954 (2) SA 109 (N) par 111. See also Sharrock *Business Transactions Law* (8th edition, Juta 2011) 790 to 793.

103 Sharrock, Van der Linde and Smith, *Hockly's Insolvency Law* (9th edition, Juta 2012) 43.

104 *Meskin & Co v Friedman* 1948 (2) SA 555 (W).

105 Insolvency Act, s 9(1).

106 *Idem*, s 12(1)(c).

by agreement, judgment or otherwise. The onus on proving advantage when applying for compulsory sequestration is less strict than under voluntary surrender[107] and there must be a reasonable prospect – not necessarily a likelihood, but a prospect which is not too remote – that sequestration will be to the advantage of creditors.[108]

6.2.3 Automatic stay (consursus creditorum)

A sequestration order results in an automatic stay of civil proceedings by or against the debtor until the appointment of a trustee and, unless the court directs otherwise, any execution against a debtor is stayed as soon as the sheriff becomes aware of the sequestration of the debtor's estate.[109] Once a trustee has been appointed legal proceedings may be proceeded with, within a prescribed timeframe and by giving requisite notice to the trustee or the Master.[110]

6.2.4 Diminished legal capacity

A sequestration order is granted by a High Court, as it involves the status of a debtor. Once the order has been granted, the insolvent has the status of diminished legal capacity (*capitis diminutio*). Upon sequestration the insolvent is divested of all of his assets, which vest in the Master and subsequently in the trustee.[111] The Insolvency Act places restrictions on the following aspects in relation to the debtor:

Contracting

The Insolvency Act does not generally deprive the debtor of his contractual capacity, but in order to protect the creditors certain restrictions are placed on the debtor's capacity to contract. The insolvent may not enter into a contract purporting to dispose of any property of his insolvent estate and may not without the written consent of the trustee enter into a contract which adversely affects (or will adversely affect) his estate or any contribution[112] which he is obliged to make towards his estate.[113]

Earning a livelihood

The debtor may follow any profession or occupation or enter into any employment during the period of sequestration but he may not, without the written consent of the trustee, either carry on, or be employed in any capacity or have any direct or indirect interest in, the business of a trader who is a general dealer or a manufacturer.[114]

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[107] Section 6(1) of the Insolvency Act states that a debtor must prove that there "will be" advantage, where s 12(1)(c) states that a creditor must prove that there "is reason to believe" that there will be advantage.
[108] Sharrock, *Business Transactions Law* (8th edition, Juta 2011) 791.
[109] Insolvency Act, s 20(1)(b) and (c).
[110] *Idem*, s 75(1).
[111] *Idem*, s 20(1)(a).
[112] Contribution is money earned by the debtor in the course of his profession, occupation or other employment, claimable by the trustee in terms of s 23(5) of the Insolvency Act, which in the opinion of the Master is not necessary for the support of the debtor and his dependents.
[113] Insolvency Act, s 23(2).
[114] *Idem*, s 23(3).

Instituting and defending legal action

The debtor may in the following instances institute and defend actions in his own name:

(a) Any matter relating to status (for example divorce proceedings) or any matter that does not affect his estate;

(b) Pension to which the debtor is entitled for services rendered by him;

(c) Remuneration for work done or for professional services rendered by him after the sequestration of his estate; and

(d) Where the matter relates to any delict committed by the debtor after the sequestration of this estate.[115]

Even though the debtor is divested of his estate, he still retains a reversionary interest therein and may accordingly institute action to ensure that the property of the insolvent estate is properly administered.[116]

Holding office

An insolvent debtor is disqualified from holding various positions, for example:

- Trustee of an insolvent estate;[117]
- Member of the National Assembly, National Council of Provinces or a provincial legislature;[118]
- A director of a company without the consent of the court;[119] and
- A business rescue practitioner.[120]

6.2.5 Alternatives to formal sequestration

Alternative measures to sequestration available to a debtor include that the debtor may apply to a Magistrate's Court for an administration order, provided that his debts do not exceed ZAR 50 000.[121] This procedure however does not offer a debtor the opportunity of discharge from his debts[122] as the order only expires after the administration costs and all the listed creditors

[115] *Idem*, s 23(6) to (10).
[116] *Kuper v Stern and Hewitt NO* 1941 WLD 1. Also see Sharrock, Van der Linde and Smith, *Hockly's Insolvency Law* (9th edition, Juta 2012) 67.
[117] Insolvency Act, s 55(a).
[118] Constitution, ss 47(1), 62 and 106.
[119] Companies Act 2008, s 69(8)(b)(i).
[120] *Idem*, s 69(8)(b)(i) read with s 138(1)(d).
[121] Magistrates' Court Act of 32 of 1944, s 74 and reg 48.
[122] See the discussion on rehabilitation below.

have been paid in full.[123] If a debtor is overindebted in terms of the National Credit Act 34 of 2005 as a result of credit granted under and regulated by this Act, the debtor may apply for debt review.[124] Debt review may result in a formalised repayment plan. A debtor may also enter into a common law compromise (voluntary agreement) with his creditors regarding a release or novation (repayment plan) with any or all of his creditors regarding his existing debts. As this common law compromise is based on agreement, all creditors of the debtor must agree to it for it to be of any practical value.[125] Making a common law compromise to his creditors also results in an act of insolvency being committed.

6.2.6 Statutory compromise

After an order for sequestration has been granted, a debtor may also shorten the period of his insolvency by making a compromise with his creditors.[126] This compromise is a statutory mechanism and the majority of the creditors need to agree, thereby binding the dissenting minority. The offer of composition needs to be accepted by creditors whose votes amount to at least three-fourths in both value and number of the total votes.[127]

6.2.7 Officeholder in sequestration (bankruptcy) proceedings

The officeholder in sequestration proceedings is called a trustee. The Master may appoint a provisional trustee after a sequestration order has been granted and before the first meeting of creditors. The Master may also appoint a provisional trustee when the person appointed as trustee ceases to be the trustee or function as such.[128] A final trustee is elected during the first meeting of creditors by creditors who have proved claims[129] against the insolvent estate.[130] Section 54 provides the following in relation to the voting process and appointment:

> "(2) Any person who has obtained a majority in number and in value of the votes of the creditors entitled to vote, who voted at such meeting, shall be elected trustee.
>
> (3) If no person has obtained such a majority of votes then–
>
> (a) the person who has obtained a majority of votes in number, when no other person has obtained a majority of votes in value, or has obtained a majority of votes in value, when no other person has

[123] Magistrates' Court Act of 32 of 1944, s 74U.
[124] National Credit Act 34 of 2005, ss 4, 86, 87 and 88.
[125] For a discussion on the common law compromise, see Sharrock, Van der Linde and Smith, *Hockly's Insolvency Law* (9th edition, Juta 2012) 203 to 205. Also see Roestoff and Boraine, "*Body Corporate Palm Lane v Masinge* 2013 JDR 2332 (GNP): Discretion and powers of the court in applications for sequestration" 2015 *De Jure* 206 to 226 for criticism on the available measures as alternatives to sequestration.
[126] Insolvency Act, s 119.
[127] *Idem*, s 119(7). See also the discussion on "rehabilitation" below.
[128] *Idem*, s 18(1). The Master also has a discretion to appoint a *curator bonis* once a debtor has applied for voluntary surrender (s 5 of the Insolvency Act).
[129] *Idem*, s 44.
[130] *Idem*, s 54(1).

obtained a majority of votes in number, shall be deemed to be elected sole trustee;

(b) if one person has obtained a majority of votes in value and another a majority of votes in number, both such persons shall be deemed to be elected trustees, and if either person declines a joint trusteeship, the other shall be deemed to be elected sole trustee."[131]

The Master needs to approve the appointment.[132]

The trustee is appointed to attend to the administration and distribution of the insolvent estate. The trustee occupies a position of trust towards both the creditors and the insolvent.[133] The assets of the insolvent vest in the trustee[134] and his duties and obligations include the following:

- he must take charge of the property of the estate;[135]
- he must ensure whether a claim proven by a creditor is due and owing;[136]
- he must open a bank account for and in the name of the estate;[137]
- he must record all amounts paid and received, and all books, accounts and other documents received, in a record book held exclusively for that purpose;[138]
- he may not use any of the assets of the estate for any purpose other than for the benefit of the insolvent estate;[139]
- he must call for special meetings of creditors where a creditor requests him to do so. In addition, a second meeting of creditors has to be held as well as additional general meetings where the Master, or at least one quarter of the creditors request him to do so;[140]

[131] *Idem*, s 54(3) and (4).
[132] *Idem*, s 56(2). For information on the role of the Master and the appointment of trustees, see Calitz and Burdette, "The appointment of insolvency practitioners in South Africa: Time for change?" 2006 *Tydskrif vir die Suid-Afrikaanse Reg* (TSAR) 721 and Burdette and Calitz, "4:3:2:1... Fair distribution of appointments or countdown to catastrophe? South Africa's ministerial policy for the appointment of liquidators under the spotlight" 3 (2015) *Nottingham Insolvency and Business Law eJournal* (*NIBLeJ*) 437. See also the discussion on regulation in para 4.2 above.
[133] *Jacobs v Hessels* 1984 (3) SA 601 (T) par 605G.
[134] Insolvency Act, s 20(1). See also para 5.2 above.
[135] *Idem*, s 69.
[136] *Idem*, s 45.
[137] *Idem*, s 70.
[138] *Idem*, s 71.
[139] *Idem*, s 72(1).
[140] *Idem*, ss 40 and 41.

- he must investigate the insolvent's affairs[141] and report back to creditors in this regard;[142]
- he must liquidate and realise the estate's assets on instruction of the creditors. Proceeds are to be distributed and contribution, if any, collected;[143] and
- he must lodge a liquidation and distribution (or contribution) account with the Master within six months of this date of appointment (setting out his administration of the estate in question).[144]

The trustee has, amongst other, the powers to obtain legal advice regarding the administration or distribution of the estate;[145] to institute legal proceedings for debts owing to the estate;[146] to instruct an attorney to act on behalf of the estate as plaintiff or defendant;[147] and to continue with the business of the insolvent.[148]

The trustee may not exercise the following powers without the consent of the Master:

- the entering of a *caveat* in the Deeds Office;[149]
- application to set aside directions by creditors;[150]
- resignation or absence from the Republic for a period longer than 60 days;[151]
- payment of an allowance to the insolvent and the family of the insolvent before the second meeting;[152]
- the sale of property before the second meeting;[153] and
- the destruction of documents.[154]

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[141] This includes, *inter alia*, the cause of and reasons for insolvency; whether proper accounts were kept by or on behalf of the insolvent; possible offences committed by the insolvent; business done on behalf of the estate by the trustee; legal proceedings pending (instituted by or against the insolvent); unexecuted contracts of sale of immovable property; and current contracts of lease. See also Nagel *et al*, *Commercial Law* (5th edition, LexisNexis 2015) 577 to 578.
[142] Insolvency Act, s 81.
[143] *Idem*, ss 81(3) and 82(16).
[144] *Idem*, s 91.
[145] *Idem*, s 73.
[146] *Idem*, s 77.
[147] *Idem*, s 73.
[148] *Idem*, s 80.
[149] *Idem*, s 18B(1).
[150] *Idem*, s 53(4).
[151] *Idem*, s 61.
[152] *Idem*, s 79.
[153] *Idem*, s 80*bis*.
[154] *Idem*, s 155.

6.2.8 Proof of claims

Creditors of the insolvent estate usually prove their claims at the first or second meeting of creditors.[155] Only creditors who have proved a claim may vote for the appointment of a trustee, subsequently give instructions to the trustee and share in the distribution. Claims must be proved by means of affidavit[156] and supporting documents, to be lodged with the presiding officer of the meeting at least 24 hours before such meeting.[157] The affidavit should clearly set out the facts upon which the claim is based, the nature and particulars of the claim, whether it was obtained by way of cession after the sequestration and the nature and particulars of any security held by the creditor and the amount at which he values it.[158] A claim must be proved to the satisfaction of the presiding officer who must either admit or reject it.[159] The trustee will still examine all admitted claims, and may dispute the claim after determining that the records of the estate do not reflect the indebtedness which is the subject of the proved claim.[160]

6.2.9 Executory contracts

The treatment of executory contracts in insolvency is not set out in legislation but is regulated by common law principles of law of contract which have been adjusted to insolvency.[161] In terms of the common law, the sequestration of a debtor's estate does not suspend or terminate any contract to which he is a party.[162] If a debtor is a party to an executory contract upon the sequestration of his estate in terms whereof the other party's performance is still outstanding, the right to that performance is an asset of the estate which the trustee may enforce.[163] If the debtor's performance in terms of the contract is still outstanding, the trustee may generally elect whether to abide by, or reject, the contract. The trustee is afforded this power so that he may act in the best interests of the creditors.[164] The trustee must thus obtain the instructions of the general body of creditors before exercising this election right. If the trustee elects to abide by the contract, he steps into the shoes of the insolvent and is entitled to receive any performance owed to the insolvent and is bound to render any reciprocal performance due to the other

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[155] Claims may be proved up until the distribution of the estate (s 104(1) and (2)) but may not be proved more than three months after the date of the second meeting, unless the Master allows a longer time period (s 44(1).

[156] Insolvency Act, s 44(4) provides that the affidavit must substantially correspond with Forms C or D in the first schedule to the Insolvency Act. Form D is used for claims based on a bill of exchange, and Form C for all other claims.

[157] *Idem*, s 44(4).

[158] If the creditor has already realised the security, he must attach to the affidavit a statement of the proceeds of the realisation and the reasons for his preference. See para 5.2 above on the enforcement of security. Also see Insolvency Act, ss 44(4) and 83.

[159] Insolvency Act, s 44(3).

[160] *Idem*, s 45.

[161] Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Van der Linde (eds) *Treatment of Contracts in Insolvency* (Oxford University Press 2013) 365 366.

[162] *Bryant and Flanagan (Pty) Ltd v Muller & another NNO* 1978 (2) SA 807 (A) 812 and *Nedcor Investment Bank v Pretoria Belgrave Hotel (Pty) Ltd* 2003 (5) SA 189 (SCA) 192.

[163] Insolvency Act, s 77.

[164] Once a sequestration order is granted, a *concursus creditorum* ("concurrency of creditors") is established and the interests of the creditors as a whole take preference over the interests of individual creditors (*Richter NO v Riverside Estates (Pty) Ltd* 1946 OPD 209 223). See also *Walker v Syfret NO* 1911 AD 141 166 for an explanation of the meaning of "*concursus creditorum*". See *Glen Anil Finance (Pty) Ltd v Joint Liquidators Glen Anil Development Corporation Ltd (in Liquidation)* 1981 (1) SA 171 (A) 182 for the right of election by the trustee.

party.[165] Should the trustee elect to reject the contract, the other party may not claim specific performance[166] and may only rely on remedies for breach of contract (being damages and cancellation).[167] Once the trustee has exercised this election right he cannot change his mind.[168]

The trustee's common law election right is limited by statute in certain instances. Legislation prescribes the treatment of the following executory contracts in insolvency:

Sale of immovable property

If the estate of the seller is sequestrated before transfer of the immovable property, the Alienation of Land Act 68 of 1981 grants some protection to the purchaser.[169] When certain requirements are met, the trustee of the insolvent estate must authorise transfer of ownership to the purchaser and as such the trustee does not have the common law election right. The requirements to be met are that the purchase price is to be paid in two or more instalments;[170] the land must be used for residential purposes; the land must be registrable in the Deeds Office; the contract must be recorded in the Deeds Office by means of an endorsement against the title deed of the land; and payment of the transfer costs and certain other cost must be made.

In the event that the estate of the purchaser is sequestrated before transfer of the immovable property, the trustee may elect whether to enforce or reject the contract. If called upon in writing by the other party to do so, the trustee must exercise this right within six weeks and, if he fails to do so, the other party may approach the court for cancellation of the contract and further restitution.[171]

Sale of movable property: cash sale

If the estate of the purchaser of movable property is sequestrated before he pays the purchase price but after he takes delivery of the property, the seller may reclaim the property if he gives written notice to the purchaser, or the trustee, or the Master, within 10 days of delivery thereof that he reclaims the property.[172] The purpose of this provision is to protect unsuspecting sellers who deliver goods to debtors shortly before bankruptcy, provided they act promptly.[173]

If the estate of the seller is sequestrated the common law position will apply.

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[165] *Bryant and Flanagan (Pty) Ltd v Muller & another NNO* 1978 (2) SA 807 (A) 812.

[166] Specific performance is a remedy available to a contracting party when the other party to the contract commits breach of contract. In terms of specific performance, the defaulting party must perform in terms of the provisions of the contract in order to fulfil the contract. See Nagel *et al*, *Commercial Law* (5th edition, LexisNexis 2015) 135.

[167] *Sonchem (Pty) Ltd v Federated Insurance Co Ltd and Another* 1983 (4) SA 609 (C).

[168] *Noord-Westelike Koöperatiewe Landboumaatskappy Bpk v Die Meester en andere* 1982 (4) SA 486 (NC) 495.

[169] Alienation of Land Act 68 of 1981, ss 18 to 22 and 27.

[170] Before the recent case of *Sarrahwitz v Maritz NO and Another* 2015 (4) SA 491 CC, the position was that the instalments had to be paid over a period of more than a year. In this case the Constitutional Court held that where the instalments were paid over a period of less than a year, such a purchaser would still be protected.

[171] Insolvency Act, s 35.

[172] *Idem*, s 36.

[173] Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Van der Linde (eds) *Treatment of Contracts in Insolvency* (Oxford University Press 2013) 365 379.

Sale of movable property: instalment agreement

When the estate of the purchaser is sequestrated when performance by the purchaser is still outstanding in terms of an instalment agreement,[174] the seller will acquire a hypothec over the goods subject to this agreement. Sequestration will thus cause ownership of the goods to pass to the insolvent estate.[175]

If the estate of the seller is sequestrated the common law position will apply.

Lease agreements

Lease agreements are not automatically terminated upon the sequestration of any of the parties' estates.[176] When the estate of the lessee of movable or immovable property is sequestrated, the trustee may immediately cancel the lease by means of written notice. The lessor has a concurrent claim against the estate for damages sustained as a result of the cancellation, but he also obtains a hypothec over immovable property brought onto the premises for any rent in arrears due before sequestration (in the case of a lease of immovable property).[177] If the trustee fails to cancel the lease within a three month period after his appointment, the lease is deemed to be cancelled automatically.[178]

Upon the sequestration of the estate of the lessor of immovable property, the sale of the property by the trustee will be bound to the lease agreement if the principle of *huur gaat voor koop* (lease goes before sale) applies.[179] If a mortgage bond[180] was registered over the property in question prior to the lease, then the rights of the lessee are subordinate to those of the mortgagee (mortgage bond holder) unless such rights have been waived. The leased property may only be sold free of the lease if an offer received for the property is inadequate to satisfy the mortgagee's claim in full and a better offer can be obtained if the property is sold free of the lease.[181]

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[174] "Instalment agreement" is in reference to the definition thereof provided in s 1 of the National Credit Act 34 of 2005. In order for the contract to comply with the relevant part of the definition, the purchase price with regard to movable property must be paid in periodic payments, the possession and use of the property must be transferred to the purchaser and the agreement must be subject to a reservation of ownership clause in that ownerships may pass to the purchaser only when the agreement is fully complied with.

[175] Insolvency Act, s 84. See also the discussion of this hypothec and the security that it provides in para 5 above.

[176] *Idem*, s 37(1) and (5).

[177] See the discussion of this hypothec and the security that it provides in para 5 above.

[178] Insolvency Act, s 37(2).

[179] This maxim is provided for in common law and provides that a lease takes precedence over sale. The practical effect thereof is that the purchaser of property is bound to the provisions of a lease agreement that is already in place between the seller and the lessee, and the purchaser as successor steps into the shoes of the current lessor (the seller).

[180] See the discussion on security in para 5 above.

[181] See Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Van der Linde (eds) *Treatment of Contracts in Insolvency* (Oxford University Press 2013) 365 384.

Employment contracts

Upon the sequestration of an employer's estate, all employment contracts are suspended.[182] In certain instances a trustee may terminate a contract of employment, but only after the trustee has entered into consultations with the relevant parties (such as registered trade unions of the employees themselves) with the view of receiving proposals in order to save or to rescue the business or a part thereof – for example to save the contracts of service when the business is sold and transferred to a new owner.[183] Unless continued employment has been agreed upon, all employment contracts terminate 45 days from the date of the appointment of the trustee.[184]

Apart from a few exceptions, the sequestration of an employee's estate has no effect on his employment contract with his employer.[185]

There are no statutory rules for the treatment of essential contracts.

6.2.10 Set-off

Under certain circumstances if set-off took place prior to the sequestration of a debtor's estate and the set-off was not in the ordinary course of business, the trustee may, with the approval of the Master, disregard the set-off and call upon the person concerned to pay to the estate the debt which he would owe it but for the set-off. A set-off taking place either between an exchange or market participant[186] and any other party in accordance with the rules of such an exchange, or under an agreement as defined in section 35B of the Insolvency Act will, however, be effective and binding on the trustee.[187] A trustee will only be able to set aside such transactions limited to collusive dealings[188] and in terms of the common law *actio Pauliana* for the setting aside of fraudulent transactions.[189]

6.2.11 Impeachable transactions

There are several measures that a trustee may employ to set aside dispositions made by the insolvent prior to the sequestration of his estate. The trustee needs to apply to court[190] in order to have a transaction set aside as an impeachable disposition. The following dispositions may be set aside:

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[182] Insolvency Act, s 38(1).
[183] *Idem*, s 38(4), (5) and (7).
[184] *Idem*, s 38(9).
[185] See the discussion on earning a livelihood and holding office, above.
[186] "Market participant" is defined in section 35A of the Insolvency Act as an authorised user, a participant, a clearing member or a client as defined in s 1 of the Financial Markets Act 19 of 2012, or any other party to a transaction.
[187] Insolvency Act, s 46.
[188] *Idem*, s 31.
[189] *Idem*, ss 35A(3) and 35B(4).
[190] Usually the Magistrate's Court. See the discussion in para 4.2 above.

Dispositions made in fraudem creditorum *("in fraud of creditors")*

In terms of the common law the *actio Pauliana* may be used by the trustee to set aside a transaction aimed at defrauding the creditors, if such a transaction indeed defrauded the creditors and diminished the assets of the estate. The trustee must prove the following:

(a) the alienation must have diminished the debtor's assets;

(b) the recipient must not have received his own property, or an asset to which he was entitled, such as the settlement of pre-existing debt;

(c) the debtor must have had the intention to defraud his creditors, but if value was received the recipient must have been aware of the intention to defraud; and

(d) the alienation must have increased or caused the insolvency of the debtor.[191]

Dispositions without value

A disposition without value, or for insufficient value, made by the insolvent may be set aside. "Value" means a benefit received or promised as a *quid pro quo*.[192] This type of disposition may be set aside under the following circumstances:

(a) if it was made more than two years prior to the sequestration, the trustee must prove that immediately after the disposition was made the debtor's liabilities exceeded his assets; or

(b) if it was made within two years of the sequestration, it will be set aside, unless the person who benefitted from the disposition can prove that the assets of the debtor exceeded his liabilities immediately after the disposition was made.[193]

Where it is proven that at any time after such a disposition has been made the insolvent's liabilities exceeded his assets by less than the amount of the disposition, the extent to which it can be set aside is limited to the amount of such excess. The Insolvency Act provides an exception to dispositions made without value: no immediate benefit under a duly registered antenuptial contract given in good faith by a man to his wife, or any child to be born of the marriage, shall be set aside as a disposition without value, unless that man's estate was sequestrated within two years of the registration of that antenuptial contract.[194]

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[191] See Nagel *et al*, *Commercial Law* (5th edition, LexisNexis 2015) 555.

[192] *Estate Jager v Whittaker & another* 1944 AD 246 250. Examples of a disposition without value include a donation, or selling an asset below market value. Whether the debtor received "value" must be decided by considering all the circumstances in which the transaction was made (*Goode, Durrant and Murray Ltd v Hewitt and Cornell NNO* 1961 (4) SA 286 (N) 291).

[193] Insolvency Act, s 26(1).

[194] *Idem*, s 27.

Voidable preferences

A disposition by a debtor can be set aside as a voidable preference if it appears that the debtor, due to his dire financial situation, was unable to pay all his creditors fully but nevertheless favoured a particular creditor, for instance by the full payment of his pre-existing debts. If a debtor made a disposition of his property within six months prior to the sequestration of his estate and the trustee can prove that it had the effect of preferring one creditor above another and immediately after such disposition his liabilities exceeded his assets, such a disposition may be set aside. Such a disposition may however not be set aside if the person in whose favour the disposition was made can prove that the disposition was made in the ordinary course of business[195] and that there was no intention to prefer one creditor above another.[196]

Undue preferences

A disposition made by the debtor at any time before sequestration may be set aside if the trustee can prove that it was made with the intention[197] of preferring one creditor above another and if at the time of the disposition the debtor's liabilities exceeded his assets.[198] There is no remedy available to the party who benefited from the disposition.

Made in collusion with another person and having the effect of prejudicing creditors or preferring one above the other

Where a debtor intentionally colluded with another person (be it a creditor or any other person) to prejudice his creditors or to prefer one creditor above the other and where the debtor then disposes of his assets, such a disposition can be set aside.[199] The trustee has to prove that the disposition, that there was collusion and that it had the effect of prejudicing creditors or preferring one creditor above another. It does not matter how long before sequestration the collusion took place, nor whether the debtor was already insolvent at the time of the disposition. The court may also order that the person who colluded with the debtor be held liable for damages suffered by the estate.[200]

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[195] An objective test is applied in deciding whether a disposition was made in the "ordinary course of business". It is to be decided whether the disposition was one which would normally be entered into between solvent business persons. See *Hendriks NO v Swanepoel* 1962 (4) SA 338 (A) 345. See also *Janse van Rensburg NO and another v Griffiths* [2014] JOL 31711 (ECP) par 16 and Mabe "Setting aside Transactions from Pyramid Schemes as Impeachable Dispositions under South African Insolvency Legislation" *Potchefstroom Electronic Law Journal* (PER / PELJ) 2016 (19).

[196] Insolvency Act, s 29.

[197] A subjective test is applied to determine whether the debtor had the intention to prefer. If the debtor did not contemplate insolvency at the time of the disposition, there was no intention to prefer (*Pretorius NO v Stock Owners' Co-operative Co Ltd* 1959 (4) SA 462 (A) 472). Other factors to be taken into consideration are whether the debtor was in a position to exercise a free choice (*Gore & Others NNO v Shell South Africa (Pty) Ltd* 2004 (2) SA 521 (C) 530) and whether there is any relationship (other than being debtor and creditor) between the debtor and the creditor to whom the disposition was made (*Cooper & another NNO v Merchant Trade Finance Ltd* 2000 (3) SA 1009 (SCA) 1016-7).

[198] Insolvency Act, s 30.

[199] *Idem*, s 31(1).

[200] *Idem*, s 31(2) and (3).

Once the trustee has discharged the onus upon him to prove the statutory grounds to have a disposition set aside,[201] the court is obliged to declare an impeachable disposition void subject to the provisions of section 33 of the Insolvency Act.

6.2.12 Exempt property

Not all property of the insolvent estate vests in the Master and then the trustee upon the granting of a sequestration order. The following property, *inter alia*, falls outside of the insolvent estate:

- Clothing and bedding of the insolvent, as well as such household furniture, tools and other essential means of subsistence as the creditors may determine;[202]
- Wages or remuneration for work done or services rendered by the insolvent after sequestration;[203]
- Pension to which the insolvent is entitled for services which he has rendered;[204]
- Compensation for defamation or personal injury;[205]
- Policy benefits under a life, disability or health policy when certain conditions are met;[206] and
- Trust property where the insolvent is the trustee of a trust.[207]

South African law does not make formal provision for a homestead exemption. Under certain circumstances, however, the insolvent may enjoy the protection of the Prevention of Illegal Eviction from Unlawful Occupation of Land Act 19 of 1998 if the facts comply with the protection afforded in terms of this Act.

6.2.13 Statutory preferent creditors

In insolvency proceedings there are three types of creditors – secured,[208] preferent and concurrent. Secured creditors receive payment from the assets they hold as security while unsecured creditors (preferent and concurrent creditors) are paid from the free residue of the estate.

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[201] *Idem*, ss 26, 29, 30 or 31 or the common law.
[202] *Idem*, s 82(6).
[203] *Idem*, s 23(9). See note 112 for the discussion on "contribution".
[204] *Idem*, s 23(7).
[205] *Idem*, s 23(8).
[206] Long-term Insurance Act 52 of 1998, s 63(1) and (2). Previously only policy benefits to an amount of ZAR 50,000 were exempt, but in terms of a recent amendment to the Long-term Insurance Act 52 of 1998 (by the Financial Services Laws General Amendment Act 45 of 2013), the full benefit is now exempt if certain conditions are met. See Nagel *et al*, *Commercial Law* (5th edition, LexisNexis 2015) 535 to 536.
[207] Trust Property Control Act 57 of 1988, s 12.
[208] See the discussion on secured creditors in para 5 above.

Preferent creditors are creditors whose claims are statutorily preferent in terms of the Insolvency Act. Concurrent creditors are creditors that have no form of security for their claims and are paid from the free residue of the estate after the secured and preferent creditors have been paid.[209] In the wide sense of the word, the term "preferent creditor" refers to a creditor who has a right to receive payment before other creditors,[210] and thus secured creditors are also preferent creditors.[211] The term "preferent creditor" is however usually reserved for a creditor whose claim is not secured, but nevertheless ranks above the claims of concurrent creditors in terms of preference provided by the Insolvency Act (that is, priority creditors).[212]

Any free residue of an estate must be applied as follows and in the following order of preference:

Funeral expenses

Any free residue shall be used to defray the costs of the funeral of the insolvent or the insolvent's spouse or minor child, if the expenses were incurred no more than three months before sequestration, up to a maximum of ZAR 300.[213]

Death-bed expenses

Thereafter any balance of the free residue remaining shall be used to defray the death-bed expenses of the insolvent or the insolvent's spouse or minor child, if the expenses were incurred no more than three months before sequestration, up to a maximum of ZAR 300.[214]

Costs of the sequestration

Thereafter any balance of the free residue remaining shall be used to defray the costs of sequestration which includes, firstly the sheriff's charges; and secondly the Master's fees in this order of priority.[215] Thereafter certain miscellaneous charges rank *pari passu*.[216]

Execution costs
Thereafter any balance of the free residue remaining shall be used to defray the taxed costs of the sheriff or messenger in connection with any execution upon the insolvent's property and in connection with any proceedings which resulted in that execution and any other taxed cost.[217]

[209] See the discussion on free residue above.
[210] See the definition of "preference" in s 2 of the Insolvency Act and the discussion in para 5 above.
[211] See the definition of "security" in s 2 of the Insolvency Act and the discussion in para 5 above.
[212] Insolvency Act, s 103.
[213] *Idem*, s 96(1).
[214] *Idem*, s 96(2).
[215] *Idem*, s 97(2)(a) and (b).
[216] *Idem*, s 97.
[217] *Idem*, s 98.

Remuneration of the business rescue practitioner[218]

Thereafter any balance of the free residue is applied to pay the remuneration of the business rescue practitioner, in an instance where business rescue proceedings are converted into liquidation proceedings,[219] to the extent that such remuneration had not been paid during business rescue.[220]

Amounts due to employees of the insolvent and certain employee schemes and funds

Any balance of the free residue is then applied to pay certain salaries, wages or other remuneration of employees of the insolvent and certain contributions that the employee had to make in his capacity as an employer – such as the pension, provident, medical aid, and unemployment fund.[221]

Employees' preferential claims are limited to the following amounts:

(a) up to a maximum of ZAR 12,000 for salary or wages not exceeding three months' salary or wages due and owing prior to date of sequestration;

(b) payment in respect of any period of leave or holiday due to the employee which has accrued as a result of employment in the year of insolvency or the previous year, provided that not more than ZAR 4,000 shall be paid out;

(c) payment in respect of any other form of absence for a period not exceeding three months prior to sequestration and not exceeding ZAR 4,000; and

(d) severance or retrenchment pay not exceeding ZAR 12,000.

Statutory obligations

Any balance of the free residue is then applied to pay statutory obligations, which rank *pari passu*. The following obligations must be paid: any amount due in terms of the Compensation for Occupational Injuries and Diseases Act 130 of 1993; any amount that the insolvent has withheld or deducted in terms of the Income Tax Act 58 of 1962; amounts due to the Mines and Works Compensation Fund; any amount due prior to the insolvency in terms of the Customs and Excise act 78 of 1973; any amount paid to the insolvent by the National Supplies

[218] This scenario would not be applicable in personal bankruptcy. The ranking of creditors in personal bankruptcy and corporate liquidation is the same and is discussed here in detail. See the discussion in para 6.3.9 below.

[219] See the discussion in para 6.5.2 below.

[220] *Diener NO v Minister of Justice* (30123/2015) [2016] GP; *Diener NO v Minister of Justice* (926/2016) [2017] ZASCA 180 (1 December 2017); *Diener NO v Minister of Justice and Correctional Services and Others* (CCT03/18) [2018] ZACC 48 (29 November 2018) and *Diener NO v Minister of Justice and Correctional Services and Others* 2019 (2) BCLR 214 (CC). It was held that the "super preference" interpretation contended by Diener undoubtedly favours business rescue practitioners and does not achieve a balance of the rights of all interested parties. Also see *Nedbank Limited v Master of the High Court and Another* (43581/16) [2019] ZAGPJHC 393 (31 October 2019) where the position in the *Diener* cases was followed and applied.

[221] *Idem*, s 98(A).

Procurement Fund as contemplated in the National Supplies Procurement Act 89 of 1970; any amount due prior to the sequestration in terms of the Value-Added Tax Act 89 of 1991; and any amount due by the insolvent in his capacity as employer to the Unemployment Insurance Fund in terms of the Unemployment Insurance Contributions Act 4 of 2002.[222]

Income tax

Any balance of the free residue is then applied to pay any tax on persons or the income or profits of persons for which the insolvent was liable under act of Parliament or provincial legislation in respect of the period prior to the sequestration.[223]

Preferences under general notarial bonds

Thereafter any balance of the free residue shall be applied to pay claims proved against the insolvent estate which are secured by a general notarial bond.[224]

6.2.14 Discharge

The insolvency of a debtor comes to an end when he is rehabilitated (discharged). Rehabilitation enables the debtor to make a new start, free from all pre-sequestration debts[225] and free from all the limitations imposed by the granting of the sequestration order.[226] The Insolvency Act provides for automatic rehabilitation of the insolvent after 10 years of the sequestration of his estate.[227]

The insolvent may also be rehabilitated before the expiry of the 10 year period in terms of a court order in the following circumstances:

(a) Composition of not less than 50 cents in the Rand. If the insolvent's creditors have agreed to composition of at least 50 cents in the Rand, the insolvent may apply for a rehabilitation order.[228]

(b) Lapse of the prescribed period after confirmation of the first account. Subject to certain qualifications, the insolvent may apply for rehabilitation after 12 months have elapsed since confirmation by the Master of the first estate account.[229]

(c) No claims proved after six months. An insolvent may apply for rehabilitation after a period of six months have elapsed from the date of sequestration, if at the time of the application

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[222] *Idem*, s 99.
[223] *Idem*, s 101.
[224] *Idem*, s 102. See the discussion in para 5 above where it is explained that a general notarial bond does not provide security as defined in the Insolvency Act.
[225] See the discussion on alternative measures to sequestration above, where these measures do not necessarily result in being discharged from debt.
[226] See Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 590 to 591.
[227] Insolvency Act, s 127A(1).
[228] Insolvency Act, s 124(1). Also see the discussion on composition above.
[229] *Idem*, s 124(2)(a). For the qualifications, see s 124(2)(b) and (c).

no claim has been proved against the estate, he has not been convicted of any fraudulent act relating to his insolvency and his estate has not been sequestrated before.[230]

(d) Full payment of all proved claims. The insolvent may apply for rehabilitation at any time after the Master has approved a plan of distribution to repay all claims proved in full as well as all costs of sequestration.[231]

The trustee, the Master as well as creditors may oppose the insolvent's application in the above circumstances.[232] There are many factors which may influence the court in not granting a rehabilitation order.[233] On application by an interested person, the court may also grant an order that the insolvent will not be automatically rehabilitated after 10 years.[234]

6.2.15 Simplified procedures for small estates

There are no simplified procedures for small estates. As discussed above, in order to voluntarily surrender his own estate, the debtor must own sufficient property to meet the costs of sequestration and a debtor without any assets (and only liabilities) may not surrender his estate. An assetless estate may only be compulsorily sequestrated.[235] Due to the complexities and burden of proof for voluntary surrender, and as a debtor without assets may not apply for voluntary surrender, some debtors make use of what is known as "friendly sequestration". It frequently occurs that a family member or a friend of the debtor is requested to bring an application for the debtor's compulsory sequestration. Such compulsory sequestration applications are known as friendly sequestrations and are usually based on an act of insolvency where the debtor gives written notice to the creditor of his inability to pay all or any of his debts.[236] As friendly sequestrations are often abused by a debtor in co-operation with a creditor to rid himself of his debt, the courts scrutinise such applications with great care in order to ascertain an advantage to creditors and to prevent prejudice to them.[237]

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230 *Idem*, s 124(3).

231 *Idem*, s 124(5).

232 *Idem*, s 127(1).

233 These factors may include *inter alia* that the debtor's liabilities were excessive; he indulged in reckless spending; and he conducted his business in manner which was dishonest and reckless. For a full discussion see Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 16 586 to 590.

234 Insolvency Act, s 127A(1). Also see s 127(A)(2) to (4).

235 *Miller v Janks* 1977 TPD 127.

236 See s 8 of the Insolvency Act, specifically s 8(g). A creditor may apply for the compulsory sequestration of a debtor's estate if he can *inter alia* prove that the debtor is insolvent or committed an act of insolvency (see s 9(1) of the Insolvency Act). The Insolvency Act sets out eight acts of insolvency.

237 See *Huntrex 337 (Pty) Ltd t/a Huntrex Debt Collection Services v Vosloo and Another* 2014 (1) SA 227 (GNP) and Evans, "Unfriendly Consequences of Friendly Sequestration" *South African Mercantile Law Journal* (SA Merc LJ) 2003 437. Also see Sharrock, Van der Linde and Smith, *Hockly's Insolvency Law* (9th edition, Juta 2012) 45 to 48. Also see *Eksteen v Van der Merwe* [2018] JOL 40301 (FB) where the court reiterated that the allegations of applicants in friendly sequestrations should be considered carefully, specifically in respect of the calculations to show what dividends might be paid to concurrent creditors.

Self-Assessment Exercise 3

Study the basic aspects dealt with in the previous section.

Question 1

Who may be considered a "debtor" in terms of section 2 of the Insolvency Act?

Question 2

Write a short note on what is meant by "advantage to creditors", and upon whom this burden of proof rests.

For commentary and feedback on self-assessment exercise 3, please see APPENDIX A

6.3 Corporate Liquidation

6.3.1 Introduction

Corporate liquidation is provided for in both the Companies Act 1973 and the Companies Act 2008. From 1 May 2011 the Companies Act 2008 repealed the Companies Act 1973, but item 9(1) of Schedule 5 provides that Chapter 14 of the Companies Act 1973 "continues to apply with respect to the winding-up and liquidation of companies under this Act, as if that Act had not been repealed."[238] The winding-up of insolvent companies is regulated by the Companies Act 1973, and the winding-up of solvent companies is regulated by the Companies Act 2008.[239] It is thus of practical importance for a company to establish whether it is solvent or insolvent upon contemplation of liquidation proceedings.[240] The Insolvency Act is further also applicable to corporate liquidation proceedings, as section 339 of the Companies Act 1973 provides that "the

[238] It would appear that the legislator, in light of future law reform that would see one unified insolvency statute, opted to have part of the Companies Act 1973 remain in force as in interim measure until such law reform took place. See the discussion on law reform in para 9 below.

[239] Item 9(2) further provides that ss 343, 344, 346, 348 to 353 of the Companies Act 1973 do not apply to the winding-up of a solvent company, except to the extent necessary to give effect to ss 79 to 83 of the Companies Act 2008. Also note that "winding-up" essentially means the procedure by which a company's assets are sold, its debts are paid, and any money left over is divided amongst the shareholder according to their rights. After the process of winding-up is complete, the CIPC will record that the company has been dissolved and will publish a notice to this effect. At this point the company ceases to exist. This guidance text will only discuss the liquidation of insolvent companies.

[240] See *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Limited* 2014 (2) SA 518 (SCA) where the court held that solvency means "commercial solvency". Also see Locke, "The meaning of 'solvent' for purposes of liquidation in terms of the Companies Act 71 of 2008: *Boschpoort Ondernemings (Pty) Ltd v ABSA Bank Ltd*: case note" *South African Mercantile Law Journal* (SA Merc LJ) 2015 153. Further, see also *Murray and Others NNO v African Global Holdings (Pty) Ltd and Others* (306/2019) [2019] ZASCA 152 (22 November 2019) for the court's discussion on "commercial solvency" and "commercially insolvent".

provisions relating to law of insolvency shall, in so far as they are applicable, be applied *mutatis mutandis* in respect of any matter not specifically provided for in this Act".[241] The provisions of the Insolvency Act are only applicable to the liquidation of an insolvent company, and not to the liquidation of a solvent company, as these provisions are only applicable to a company unable to pay its debts.[242]

The definition of "debtor" in the Insolvency Act expressly excludes a company which may be placed under liquidation under the law relating to companies, and the estate of a company thus cannot be sequestrated.[243] Liquidation proceedings are used for corporate debtors, and both companies and close corporations[244] are wound-up and liquidated.

6.3.2 Modes of liquidation

A company may be wound up by means of either a voluntary winding-up or a winding-up by court (compulsory winding-up).[245] A voluntary winding-up is initiated by a special resolution of the shareholders of the company,[246] which resolution has to state whether it is a winding-up by creditors (a creditors' voluntary winding-up) or by the shareholders (a members' voluntary winding-up).[247] Voluntary winding-up is an out-of-court procedure which commences upon filing of the special resolution of the shareholders. In order for a company to enter into voluntary liquidation by members, the company must either have no debts or must be able to provide security for the payment of all debts within 12 months of filing the resolution[248] and for this reason the voluntary liquidation of an insolvent company is usually a creditors' winding-up as it is under the direction of the creditors.[249]

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[241] Many matters such as impeachable dispositions; application of assets to costs and claims; proof of claims; meetings; and the treatment of executory contracts (the exceptions provided for in legislation) are dealt with in terms of the provisions of the Insolvency Act and the provisions are the same as under sequestration proceedings.

[242] Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Richter (eds) *Commencement of Insolvency Proceedings* (Oxford University Press 2012) 521 538. For a discussion on inability to pay debts, see below.

[243] See the discussion in para 6.2 above.

[244] The liquidation of close corporations is regulated by the Close Corporations Act 69 of 1984 (the "Close Corporations Act"), but this Act effectively incorporates many of the winding-up provisions of the Companies Act 1973 and the Companies Act 2008. Section 66(1) of the Close Corporations Act provides that the provisions of Ch 14 of the Companies Act 1973, with the changes required in context, applies to the liquidation of a close corporation, unless the matter has specifically been provided for by the Close Corporations Act. Section 66(2) of the Close Corporations Act sets out how various words and phrases in the Companies Act 1973, Companies Act 2008 and the Insolvency Act should be interpreted when applied to close corporations. In terms of the Companies Act 2008, no new close corporations may be established but those that existed prior to 1 May 2011 will continue to exist. Only the liquidation of companies will be discussed in this guidance text.

[245] Companies Act 1973, s 343(1).

[246] *Idem*, ss 343(2) and 349. A special resolution is a resolution adopted with the support of at least 75% of the voting rights exercised on the resolution. See ss 64(1)(a) and 65(9) of the Companies Act 2008.

[247] *Idem*, ss 343(2), 350(1) and 352(1).

[248] *Idem*, s 350(1)(b).

[249] Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Richter (eds) *Commencement of Insolvency Proceedings* (Oxford University Press 2012) 521 537.

A compulsory winding-up is initiated by an application to court, and the Companies Act 1973 sets out many grounds upon which a company may be wound up by the court.[250] The ground most often used is that the company is unable to pay its debts[251] and a creditor can establish this in a number of ways.[252] It must be established that the company is unable to a pay a debt of at least ZAR 100. Unlike the position in an application for compulsory sequestration,[253] the applicant creditor's claim need not equal or exceed any particular amount – the requirement of debt of at least ZAR 100 is relevant only to prove the company's inability to pay its debts. An application for the winding-up of an insolvent company may be made by the company, one or more creditors, one or more shareholders or jointly by a combination of these.[254]

The consequences of a voluntary winding-up and a compulsory winding-up are generally the same,[255] but there are some provisions that apply "after a winding-up order has been made" and are thus not applicable to voluntary liquidations.[256]

In order to avoid a finding of recklessness against its directors, a company must stop trading when there is no reasonable prospect that it would be able to satisfy its obligations to creditors when they become due.[257] Under such circumstances the company would in all likelihood apply for liquidation. The Companies Act 2008 contains a prohibition on fraudulent, reckless and grossly negligent trading.[258] The CIPC may instruct a company to cease trading if the company is unable to disprove a reasonable suspicion that it is infringing this provision or that it is unable to pay its debts.[259] The issuing of such a compliance notice by the CIPC may be likely to encourage a company to enter liquidation.[260]

There is no provision for the automatic conversion of liquidation proceedings into a business rescue. If liquidation proceedings have already commenced at the time that a business rescue application is brought to court, the business rescue application will suspend the liquidation proceedings until the court has adjudicated upon the application, or until the end of the

[250] Companies Act 1973, s 344.
[251] *Idem*, s 344(f). This section contains many other grounds upon which a company may be liquidated, but most of these grounds are also aimed at solvent companies and the only other ground of significance to an insolvent company is if it is "just and equitable" to wind up the company (s 344(h)).
[252] *Idem*, s 345.
[253] See the discussion in para 6.2.2 above.
[254] *Idem*, s 346.
[255] *Idem*, ss 364 and 368.
[256] See, eg, s 417 of the Companies Act 1973 which provides for interrogations of directors and others regarding the affairs of the company. Also see Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Richter (eds) *Commencement of Insolvency Proceedings* (Oxford University Press 2012) 521 537.
[257] *Philotex v Snyman* 1998 (2) SA 138 SCA. Also see the discussion on directors' liability below.
[258] Companies Act 2008, s 22(1).
[259] *Idem*, s 22(3).
[260] Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Richter (eds) *Commencement of Insolvency Proceedings* (Oxford University Press 2012) 521 541.

business rescue proceedings should the court grant the order applied for.[261] Such an order may even be granted after the final liquidation order has been issued.[262]

6.3.3 Automatic stay (consursus creditorum)

After a company has been placed under liquidation, there is stay on the following:

- any share transfer is void except with the consent of the liquidator;[263]
- every disposition of property is void unless the court orders otherwise;[264]
- all civil proceedings against the company are suspended until the appointment of the liquidator, after which these proceedings may commence or continue if the requisite notice is provided to the liquidator;[265]
- any attachment or execution put in force is void;[266] and
- the company may not continue with its business, except in so far as may be necessary for its beneficial winding-up.[267]

A company that is not under business rescue[268] may resort to a compromise with its creditors, regardless of whether it is being wound up.[269] A pre-liquidation compromise can be regarded as an alternative to liquidation proceedings, but it does not provide for a moratorium and as such a creditor may still apply for liquidation at any time. As a result, companies initiate voluntary liquidation proceedings and thereafter propose a post-liquidation compromise, thereby obtaining the benefit of a stay on legal proceedings.[270] When a company under liquidation enters into a compromise with its creditors, it is usually a condition of the compromise that the company be released from liquidation. The company will have to apply to court for the setting

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[261] Companies Act 2008, s 131(6). See also *Van Niekerk v Seriso 321 CC and Another* (952/11, 23929/11) [2012] ZAWCHC 63 (20 March 2012). The functions of a provisional liquidator are unaffected by the suspension of liquidation proceedings (*C Rock (Pty) Ltd v H.C. van Wyk Diamonds Ltd and Others* (2355/2018) [2018] ZANCHC 91 (7 December 2018)).

[262] This was clearly envisioned by s 136(4) of the Insolvency Act. See *Richter v Absa Bank Limited* 2015 (5) SA 57 (SCA). Also see *Van der Merwe v Zonnekus Mansion (Pty) Ltd (in liquidation)* (4653/2015) [2015] WCC (10 June 2015) where the judge disagreed with the decision by the Supreme Court of Appeal in *Richter v Absa Bank Limited*, but was bound by it.

[263] Companies Act 1973, s 341(1).

[264] *Idem*, s 341(2).

[265] *Idem*, s 359(1) and (2).

[266] *Idem*, s 359(1)(b).

[267] *Idem*, s 353(1).

[268] See the discussion in para 6.5 below.

[269] Companies Act 2008, s 155. Also see Sharrock, Van der Linde and Smith, *Hockly's Insolvency Law* (9th edition, Juta 2012) 241.

[270] Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Richter (eds) *Commencement of Insolvency Proceedings* (Oxford University Press 2012) 521 529.

aside of the liquidation order or, if a provisional order has been made, oppose the granting of a final order on the return day of the rule *nisi*.[271]

6.3.4 Officeholder in liquidation proceedings

The officeholder in liquidation proceedings is called a liquidator. After the granting of an order of liquidation in a compulsory liquidation, or once the resolution has been filed in a voluntary liquidation, the Master may appoint any suitable person as provisional liquidator of the company who will hold office until the appointment of the liquidator.[272] The Master must appoint as liquidator:

- in the case of a members' voluntary winding-up, the person (or persons) nominated in the resolution lodged with the special resolution for the winding-up of the company;[273]

- in the case of a creditor's voluntary winding-up and a winding-up by the court, the person (or persons) nominated by the first meeting of creditors and the initial meeting of members.[274] If these meetings nominate different persons, the Master must decide whether either or both are to be appointed.[275]

The primary duty of a liquidator is to take possession of all the movable and immovable property of the company,[276] to realise this property in the prescribed manner, to apply proceeds towards payment of the costs of the winding-up and the claims of creditors, and to distribute any balance among the members.[277] In a winding-up by the court and creditors' voluntary winding-up, the liquidator must have regard to any directions given by resolution of the creditors or members.[278] The liquidator stands in a fiduciary relationship to the company, to the body of its members as a whole, and to the body of its creditors as a whole. The powers of a liquidator may be exercised (i) without any permission required; (ii) only with the consent of the Master; or (iii) with the authority of members and creditors.

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[271] *Idem*, 521 570. In accordance with the Companies Act 1973, s 354, a court has the power to stay or set aside a winding up at any time after commencement thereof and not only in relation to a compromise.

[272] Companies Act 1973, s 368. See also *De Beer NO and others v Magistrate of Dundee NO and others* (2021) 1 All SA 405 (KZP) where it was held that a court has no power to declare valid any act of a provisional liquidator performed by such provisional liquidator prior to be being properly appointed.

[273] *Idem*, s 369(1).

[274] *Idem*, s 369(2)(a).

[275] *Idem*, s 396(2)(b). See *Khammissa and Others v Master, Gauteng High Court, and Others* 2021 (1) SA 421 (GJ) for a discussion on when the Master is *functus officio*. For information on the role of the Master and the appointment of liquidators, see Calitz and Burdette, "The appointment of insolvency practitioners in South Africa: Time for change?" 2006 *Tydskrif vir die Suid-Afrikaanse Reg* (TSAR) 721 and Burdette and Calitz, "4:3:2:1... Fair distribution of appointments or countdown to catastrophe? South Africa's ministerial policy for the appointment of liquidators under the spotlight" 3 (2015) *Nottingham Insolvency and Business Law eJournal* (*NIBLeJ*) 437. See also the discussion on regulation in para 4.2 above.

[276] Unlike a debtor under sequestration proceedings, the company remains the owner of its property and only the control over the company goes to the Master and then the liquidator - Companies Act 1973, s 361(1).

[277] Companies Act 1973, s 391.

[278] *Idem*, ss 387(1) and 351(2).

Powers for which no permission is required

- Execute in the name of the company any deed, receipt or other document, using the company's seal;
- Prove a claim in the estate of a debtor of a company and receive payment of any dividend;
- Draw, accept, make and endorse any bill of exchange or promissory note on behalf of the company; and
- Summon a general meeting of the company, or of creditors, in order to obtain authority in regard to any matter he considers necessary.[279]

Powers requiring Master's consent

- Before convening the general meeting referred to above, terminate a lease under which the company has hired movable or immovable property;[280]
- At any time before the general meeting referred to above, sell any movable or immovable property of the company;[281] and
- Urgent legal proceedings for the recovery of outstanding amounts owing to the estate.[282]

Powers requiring authority of members and creditors

Most of the powers of the liquidator may only be exercised with the authority of creditors or members (or both). In a winding-up by the court, the authority must be granted by meetings of members and creditors. In the case of a members' voluntary winding-up, the authority must be granted by a meeting of members, and in a creditors' voluntary winding-up, from a meeting of creditors.[283] The powers that require authority are:[284]

- Institute and defend legal proceedings generally (urgent legal proceedings may be authorised by the Master);
- Compromise debts due to the company, or to accept part payment by a debtor in settlement of his debts;
- Make an arrangement with creditors, except if the company is unable to pay its debts;
- Submit disputes to arbitration;

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[279] *Idem*, s 386(1)(a) to (d).
[280] *Idem*, s 386(2).
[281] *Idem*, s 386(2A) and (2B).
[282] *Idem*, s 386(4)(a).
[283] *Idem*, s 386(3).
[284] *Idem*, s 386(4)(a) to (i).

- Carry on or discontinue any part of the business of the company in so far as may be necessary for its beneficial winding-up;

- Enforce or abandon uncompleted contracts for the acquisition of immovable property;

- Terminate contracts of lease;

- Sell any movable and immovable property of the company by public auction, public tender or private contract, and deliver the property; and

- Perform any act or exercise any power for which the Companies Act 1973 does not expressly require him to obtain the leave of the court.

Obligations of the liquidator

The liquidator has the following obligations:

- Providing information to the Master;[285]

- Keeping records of all money, goods, books, accounts and other documents received by him on behalf of the company;[286]

- Opening a current account in the name of the company and depositing all moneys which he receives for the company;[287]

- Examining the affairs and transactions of the company before its winding-up to establish whether any directors have contravened any provision of the Companies Act 1973 and if so take the necessary steps in that regard;[288]

- Reporting to creditors within three months of his appointment by submitting a report to a general meeting of creditors;[289]

- Drafting a liquidation and distribution (or contribution) account to be lodged with the Master within six months of his appointment;[290] and

- Distribution of the assets once the liquidation and distribution account has been confirmed by the Master.[291] Unless the company's constitutional documents provide otherwise, any

[285] *Idem*, s 392.
[286] *Idem*, s 393(1).
[287] *Idem*, s 394(1).
[288] *Idem*, ss 400 and 401.
[289] *Idem*, s 402. For the content of the report, see s 402(a) to (i). This requirement is not applicable in the case of a members' voluntary winding-up.
[290] *Idem*, s 403(1).
[291] *Idem*, s 409.

assets remaining after payment of costs and creditors must be distributed among member according to their interest and rights in the company.[292]

6.3.5 Proof of claims by creditors

In a winding-up by the court or a creditors' voluntary winding-up, creditors must prove their claims against the company at creditors' meetings *mutatis mutandis* in accordance with the provisions relating to proof of claims against an insolvent estate as provided for by the Insolvency Act.[293] In a members' voluntary winding-up creditors do not have to prove their claims – the liquidator simply settles all outstanding debts, realises the assets, and submits the liquidation and distribution account to the Master.

The common law principles and statutory exceptions in terms of the Insolvency Act applicable to executory contracts also apply to the winding-up of a company unable to pay its debts.[294] The liquidator of a company may invoke both sections 35 and 37 of the Insolvency Act – provided that the meeting of creditors or members grant their authority, or on directions of the Master in case of a winding-up by the court. In the case of a voluntary winding-up by creditors or members respectively, the liquidator may act likewise on the authority of the creditors granted at a meeting of creditors, or the members granted at a meeting of members. Just as with the sequestration of a debtor's estate, there are no rules for the treatment of essential contracts.

6.3.6 Set-off

The provisions relating to set-off under the Insolvency Act are also applicable to liquidations[295] and the liquidator will be bound to a set-off that took place either between an exchange or market participant[296] and any other party in accordance with the rules of such an exchange, or under an agreement as defined in section 35B of the Insolvency Act.[297] The liquidator will also not be able to invoke the claw-back provisions relating to these types of transactions.[298]

6.3.7 Impeachable transactions

In the liquidation of a company regulated under the Companies Act 1973, the provisions of the Insolvency Act regarding impeachable dispositions will apply with the necessary changes.[299] To facilitate the application of these provisions, the Companies Act 1973 provides that the event which is deemed to correspond with the sequestration order in the case of an individual is:

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[292] *Idem*, s 342.
[293] *Idem*, s 366(1). See the discussion in para 6.2 above on proving claims against the insolvent estate of a debtor.
[294] *Idem*, s 339. See the discussion in para 6.2 above.
[295] *Idem*, s 339. See the discussion in para 6.2 above.
[296] "Market participant" is defined in s 35A of the Insolvency Act as an authorised user, a participant, a clearing member or a client as defined in s 1 of the Financial Markets Act 19 of 2012, or any other party to a transaction.
[297] Insolvency Act, s 46.
[298] In terms of s 341 of the Companies Act 1973, any disposal by a company of an asset after the deemed commencement of winding-up is void.
[299] Companies Act 1973, s 340.

(a) the presentation of the application for winding-up to the court (unless that winding-up supersedes a voluntary winding-up, in which case the registration of the special resolution to wind up the company is the determining moment);

(b) where the winding-up supersedes a (former) judicial management order of a company not able to pay its debts, the presentation of the application to court for cancellation of the judicial management under section 433(1) or 440 of the Companies Act 1973;[300] and

(c) in the case of a creditors' voluntary winding-up, the registration of the special resolution to wind up.[301]

6.3.8 Directors' liability

Director's liability for reckless or fraudulent trading is governed by both the Companies Act 1973 and the Companies Act. In terms of the Companies Act 1973, if it appears that during a winding-up of a company or otherwise, the business of the company has been carried on recklessly or with the intent to defraud creditors or for any other fraudulent purpose, the court may impose personal liability on the former directors or officers concerned for any or all of the debts of the company.[302] Trading under insolvent circumstances does not necessarily amount to fraudulent or reckless trading.[303] The Companies Act 2008 provides that any person that contravenes the Act is liable to any other person for any loss or damage suffered by that person as a result of the contravention.[304] Although directors have no direct defence based on formal rescue proceedings, courts have been tolerant of directors who were pursuing informal turnaround strategies.[305]

6.3.9 Ranking of claims

The ranking applicable in terms of the Insolvency Act is also applicable to the liquidation of companies in relation to the claims of creditors and administration costs. Provision is further also made for distribution amongst members of the company according to their rights and interests in the company.[306]

6.3.10 Groups of companies

A single application may not be used to apply for the liquidation of a group of companies, except possibly with the consent of all interested persons or where there is a complete identity

[300] Judicial management has been replaced by the corporate rescue mechanism called business rescue. See the discussion in para 6.5 below.
[301] Companies Act 1973, s 340(2).
[302] *Idem*, s 424. This section is only applicable when a company is placed in liquidation. It is also applicable to solvent liquidations, as it has not been expressly excluded in item 9(2) of the Schedule 5 of the Companies Act 2008 (see note 239 above).
[303] *Ozinsky NO v Lloyd & others* 1995 (2) SA 915 (A).
[304] Companies Act 2008, s 218(2).
[305] *Fourie NO v Newton* [2011] 2 All SA 265 (SCA).
[306] Companies Act 1973, s 342. See the discussion of preferent creditors in para 6.2 above.

of interests as between the companies concerned.[307] In *Cooper NO v Micromatica 324 (Pty) Ltd*[308] the court simultaneously with the liquidation orders for three companies declared the three companies a single entity as envisaged by, amongst others, section 20(9) of the Companies Act 2008. If associated companies are being liquidated, the same liquidator is usually appointed to the different entities. This assists the liquidator in understanding the dynamics and detecting unjustified intra-group transactions.[309]

6.3.11 Dissolution and deregistration

Once the affairs of a company have been wound up, the Master has to certify this and notify the Registrar of Companies, who must record the dissolution of the company and publish a notice in the *Government Gazette*.[310]

A company may apply to the CIPC for its deregistration on the basis that it has ceased to carry on business and either has no assets or, because of the inadequacy of its assets, there is no reasonable probability of it being liquidated.[311]

Self-Assessment Exercise 4

Study the basic aspects dealt with in the previous section.

Question 1

Company A, Company B and Company C all form a group of companies, and are all unable to pay their respective debts. With reference to case law, what principles regarding the opening of insolvency proceedings may find application to such a group of companies?

For commentary and feedback on self-assessment exercise 4, please see APPENDIX A

6.4 Receivership

There is no receivership procedure in South Africa.

[307] *Brack v Front Runner Racks 2000 (Pty) Ltd* (45084/2010) [2011] ZAGPJHC 34 (4 May 2011).
[308] (41820/2015) [2016] WCC (10 October 2016).
[309] *Pellow NO and others v The Master of the High Court and others* 2012 (2) SA 491 (GSJ). For potential conflicts that may arise in this regard if the companies are creditors of each other, see *Standard Bank of South Africa v The Master of the High Court and others* 2010 (4) SA 405 (SCA).
[310] Companies Act 1973, s 419(1)(and (2). See also *Pieters NO v Absa Bank Ltd* 2021 (3) SA 162 (SCA).
[311] Companies Act 2008, s 82(3)(b)(ii).

6.5 Corporate Rescue

6.5.1 Introduction

The reorganisation of companies and close corporations can be achieved by commencing business rescue proceedings (statutorily regulated in the Companies Act 2008), or through a pre- or post-liquidation composition with creditors (only post-liquidation compromises are statutorily regulated, although nothing prevents a company from undergoing an informal out-of-court restructuring process).[312]

The purpose of business rescue (the name given to the South African corporate rescue procedure) is to facilitate the rehabilitation of a financially distressed company.[313] A company is regarded as financially distressed if it appears reasonably unlikely that the company will be able to pay all its debts as they fall due and payable within the ensuing six months, or if it appears reasonably likely that the company will become insolvent within the immediately ensuing six months.[314] The procedure is also available to close corporations, but only companies will be covered in this guidance text.[315]

6.5.2 Commencement of business rescue proceedings

Business rescue proceedings may be commenced via a voluntarily or compulsory route. Voluntary business rescue is initiated by the board of a company upon the adoption of a resolution to this effect and the proceedings become effective once this resolution has been filed with the Companies and Intellectual Property Commission (CIPC).[316] Upon adopting this resolution, the board of a company must also have reasonable grounds to believe that there appears to be a reasonable prospect of rescuing the company.[317] Compulsory business rescue is initiated by a court order after an application is brought by an affected person.[318]

The Companies Act 2008 clearly states that rescuing a company entails "maximis[ing] the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for

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[312] *Idem*, s 155. Also see Sharrock, Van der Linde and Smith, *Hockly's Insolvency Law* (9th edition, Juta 2012) 241. For close corporations, an alternative post-liquidation procedure is provided for by s 72 of the Close Corporations Act. See the discussion in para 6.3 above on compromise.

[313] *Idem*, s 128(1)(b).

[314] *Idem*, s 128(1)(f).

[315] As with liquidation. See the discussion in para 6.3 above.

[316] Companies Act 2008, s 129. See *Mouton v Park 2000 Development 11 (Pty) Ltd and Others and a Related Matter* 2019 (6) SA 105 (WCC) where the court distinguished between the words "commenced" and "begin" in relation to winding-up provisions, as opposed to the word "initiated" in s 129(2)(a).

[317] *Idem*, s 129(1)(b). "Reasonable prospect" means something less is required than that the recovery should be a reasonable probability but would rather indicate a reasonable possibility (*Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* [2013] JOL 30498 (SCA)). Also see *Newcity Group v Allan David Pellow NO* (577/2013) [2014] ZASCA 162 (1 October 2014) and Joubert, "'Reasonable possibility' versus 'reasonable prospect': Did business rescue succeed in creating a better test than judicial management?" 2013 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg / Journal of Contemporary Roman-Dutch Law* (THRHR) 550.

[318] *Idem*, s 131. An "affected person" is a shareholder or creditor of the company, any registered trade union representing employees of the company and any employees not represented by a trade union (as defined in s 138(a) of the Companies Act 2008).

the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company".[319]

Business rescue proceedings may thus be used where (i) the company is under financial distress and there is a reasonable prospect that by making use of business rescue the company will continue in existence on a solvent basis; or (ii) where there is no reasonable prospect of the company continuing in existence, but business rescue will result in a better result for creditors or shareholders than the immediate liquidation of the company.[320] In an instance where there is no longer a reasonable prospect that the company can be rescued, the business rescue practitioner has to apply to court for an order placing the company under liquidation.[321] There is no provision for the automatic conversion of business rescue proceedings into liquidation proceedings – a court order is required in this regard.

If the board of directors has reasonable grounds to believe that a company is financially distressed and then does not adopt a resolution placing the company under voluntary business rescue, it must notify each affected person in writing of the relevant criteria of financial distress that apply to the company and the board's reasons for not adopting such a resolution.[322]

6.5.3 Moratorium (stay)

Business rescue proceedings result in a moratorium on legal proceedings against the company. The moratorium is inclusive of enforcement action against the company, or in relation to any property belonging to the company, or lawfully in its possession. The business rescue practitioner or the court may grant permission to lift the moratorium in appropriate cases.[323] To the extent that the company is liable as a debtor which includes its liability as a surety, the suretyship may not be enforced against the company unless the court grants permission on the grounds that it is just and equitable to do so.[324] The moratorium does not apply to certain proceedings:

- criminal proceedings against the company or any of its directors or officers;[325]
- proceedings against the company by a regulatory authority in the execution of its duties (the authority may continue with the proceedings after written notification to the business rescue practitioner);[326]

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[319] *Idem*, s 128(b)(iii).
[320] See *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* [2013] JOL 30498 (SCA). Also see *Griessel and Another v Lizemore and Others* (2015/24751) [2015] ZAGPJHC 189; [2015] 4 All SA 433 (GJ) (31 August 2015) where the court laid down criteria to be satisfied in cases where a better return for shareholders or creditors is the ultimate goal.
[321] Companies Act 2008, s 141(2).
[322] *Idem*, s 129(7).
[323] *Idem*, s 133.
[324] *Idem*, s 133(2). See *Hitachi Construction Machinery Southern Africa Co (Pty) Ltd v Botes and Another* (205/2018) [2019] ZANCHC 7 (15 March 2019) where the court held that the liability of a surety, however, is unaffected by the business rescue of the principal debtor.
[325] *Idem*, s 133(1)(d).
[326] *Idem*, s 133(1)(f).

- proceedings concerning any property or right over which the company exercises the powers of a trustee;[327] and

- proceedings instituted as a set-off against any claim made by the company itself in any legal proceedings.[328]

It has recently been decided that the moratorium does not preclude a creditor from cancelling an executory contract after the debtor company has been placed under business rescue.[329]

6.5.4 Appointment of business rescue practitioner, powers and obligations

Within five business days after filing a resolution to commence voluntary business rescue with the CIPC, a company has to appoint a business rescue practitioner who satisfies the requirements for appointment[330] and who has consented in writing to such appointment.[331] Within two days of this appointment, the company must file a notice of appointment and publish a copy of this notice to each affected person within five days of filing the notice.[332] Upon granting an order for compulsory business rescue, a court may appoint an interim business rescue practitioner nominated by the applicant, subject to ratification of the holders of the majority of independent creditors' voting rights at the first meeting of creditors.[333]

During a company's business rescue proceedings, the business rescue practitioner has full management control of the company in substitution for the board and management.[334] He may delegate powers and functions to directors or other persons who formed part of management, remove from office any member of that management, and appoint persons as part of management, whether to fill a vacancy or not.[335] As soon as possible after his appointment, the business rescue practitioner must inform all relevant regulatory authorities of his appointment and that the company has been placed under business rescue.[336]

The most important functions of the business rescue practitioner are to investigate the affairs of the company and to develop and implement a business rescue plan. The business rescue practitioner is an officer of the court and is subject to the duties and liabilities of a director of a

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[327] *Idem*, s 133(1)(e). Also see *Afrimat Iron Ore (Pty) Ltd v Timasani (Pty) Ltd (in business rescue) and another* [2019] JOL 41473 (GP) in this regard.
[328] *Idem*, s 133(1)(c).
[329] *Cloete Murray NO & another v FirstRand Bank Ltd* [2015] ZASCA 39 (26 March 2015). Also see Lawrenson, "Lease agreements and business rescue: in need of rescue?" 2018 *Tydskrif vir die Suid-Afrikaanse Reg* (TSAR) 657. See further the discussion on the treatment of executory contracts below.
[330] As set out in s 138 of the Companies Act 2008.
[331] Companies Act 2008, s 129(3)(b).
[332] *Idem*, s 129(4).
[333] *Idem*, s 131(5). An "independent creditor" is a creditor of the company (including an employee) that is not related to the company, a director, or the business rescue practitioner (as defined in s 138(g) of the Companies Act 2008).
[334] *Idem*, s 140(1)(a).
[335] *Idem*, s 140(1)(b).
[336] *Idem*, s 140(1A).

company.[337] Upon investigating the affairs of the company, the business rescue practitioner is required to consider whether there is any reasonable prospect of the company being rescued.[338] If the business rescue practitioner is of the opinion that there is no reasonable prospect for the company to be rescued, he should inform the court, the company and all affected as such, and request the court for an order to discontinue the business rescue and place the company under liquidation.[339] If the business rescue practitioner is of the opinion that the company is no longer under financial distress, he must inform the court, the company and all affected persons and apply to court for an order to discontinue the business rescue proceedings (for compulsory business rescue) or file a notice of termination with the CIPC (for voluntary business rescue).[340]

A company under business rescue may dispose of its property in the ordinary course of business.[341] To dispose of property outside the ordinary course of business, the disposal must be a *bona fide* transaction at arm's length for fair value approved in writing in advance by the business rescue practitioner; or the disposal must be in accordance with the approved business rescue plan.[342] If the property subject to the disposal has been given as security to a creditor, the prior consent of the creditor is required, except where the proceeds of the disposal will be sufficient to discharge the debt secured by the property.[343]

6.5.5 Post-commencement finance

During business rescue proceedings, a company may obtain financing, secured if necessary by any of the company's assets which are not otherwise encumbered.[344] The claims of these creditors are payable after costs related to the business rescue proceedings and claims related to employment arising during the rescue proceedings, in the order of preference indicated in the Companies Act 2008.[345] The order of preference is as follows:

(a) Business rescue practitioner's remuneration and other expenses;[346]

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[337] *Idem*, s 140(3)(a) and (b). The business rescue practitioner is expected to act objectively and impartially in the conduct of the business rescue proceedings. In instituting legal proceedings, an objective and impartial attitude is to be expected. See *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and Others* 2015 (5) SA 192 (SCA) par 38 and *Booysen v Jonkheer Boerewynmakery (Pty) Ltd and Another* 2017 (4) SA 51 (WCC) par 70.

[338] *Idem*, s 141(1). The requirement of reasonable prospect of rescuing the company should not be confused with the same requirement upon the commencement of the proceedings, as discussed above. This requirement must be present at the time of opening the proceedings as well as during the proceedings.

[339] *Idem*, s 141(2)(a).

[340] *Idem*, s 141(2)(b).

[341] *Idem*, s 134(1)(a)(i).

[342] *Idem*, s 134(1)(a)(ii) and (iii).

[343] *Idem*, s 134(3)(a).

[344] *Idem*, s 135(2).

[345] *Idem*, s 135.

[346] *Idem*, s 135(3). See also *Murgatroyd v Van den Heever and Others NNO* 2015 (2) SA 514 (GJ), *Diener NO v Minister of Justice* (926/2016) [2017] ZASCA 180 (1 December 2017); *Diener NO v Minister of Justice and Correctional Services and Others* (CCT03/18) [2018] ZACC 48 (29 November 2018) and *Diener NO v Minister of Justice and Correctional Services and Others* 2019 (2) BCLR 214 (CC).). It was held that the "super preference" interpretation contended by Diener undoubtedly favours business rescue practitioners and does not achieve a balance of the

(b) Remuneration, reimbursement for expenses or other amounts of money relating to employment which becomes due and payable by a company to an employee during the company's business rescue proceedings;[347]

(c) Claims for financing obtained during business rescue (firstly secured claims in the order in which they were incurred, in preference over all unsecured claims against the company);[348]

(d) Employees for claims which became due before commencement of the business rescue proceedings;[349] and

(e) Preference provided for in the business rescue plan proposals.[350]

6.5.6 Claims by creditors

In business rescue proceedings there is a clear distinction between pre- and post-commencement claims. The scope and ranking of post-commencement claims is set out in legislation and only pre-commencement claims are part of the business rescue plan. The business rescue practitioner may receive proof of claims by creditors at the first meeting of creditors.[351] There is an absence of guidelines for the administration of claims in business rescue proceedings, and this creates uncertainty.[352] As the treatment of the claim does not seem to depend on whether or not a claim has been proved, it may be that it is simply beneficial to assist the business rescue practitioner in establishing a list of the company's debts and resolve possible disputes regarding claims.[353]

6.5.7 Business rescue plan

The business rescue practitioner must, after consulting the creditors, other affected persons, and the management of the company, prepare a business rescue plan for consideration and possible adoption at a meeting convened for this purpose.[354] The business rescue plan must

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rights of all interested parties. Also see *Nedbank Limited v Master of the High Court and Another* (43581/16) [2019] ZAGPJHC 393 (31 October 2019) where the position in the *Diener* cases was followed and applied.

[347] *Idem*, s 135(1).

[348] *Idem*, ss 135(2) and 135(3)(a) and (b).

[349] *Idem*, s 144(2).

[350] The business rescue plan has to set out full details of the creditors and their claims – whether they are secured, preferent or concurrent in terms of the Insolvency Act, including the amount they would receive in liquidation (s 150(2)(a)(ii) and (iii) of the Companies Act 2008). This will enable the creditors to take an informed decision on the plan. See also see *The Commissioner, South African Revenue Service v Beginsel NO and Others* 2013 (1) SA 307 (WCC)). This however has no effect on the ranking under business rescue. The Commissioner for Inland Revenue and other creditors who enjoy a preference in terms of ss 98 to 102 of the Insolvency Act do not enjoy a preference during business rescue proceedings (*The Commissioner, South African Revenue Service v Beginsel NO and Others* 2013 (1) SA 307 (WCC)).

[351] *Idem*, s 147(1)(a)(ii).

[352] See Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn, Richter and Tirado (eds) *Ranking and Priority of Creditors* (Oxford University Press 2016) 441 444.

[353] Companies Act 2008, s 152(4). See also Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn, Richter and Tirado (eds) *Ranking and Priority of Creditors* (Oxford University Press 2016) 441 453.

[354] *Idem*, s 150(1). For more on the consultation process, see *Hlumisa Investment Holdings (RF) Limited and another v Van der Merwe NO and others* [2016] JOL 34326 (GP) para 22 and 23.

contain all the information reasonably required to facilitate affected persons in deciding whether or not to accept or reject the plan,[355] and must be published within 25 days after the appointment of the business rescue practitioner.[356] A business rescue plan is adopted on a preliminary basis by creditors (subject to approval by holders of securities if their interests are affected) if it is supported by 75% of voting interests and 50% of independent creditors' voting interest (if any).[357] If the business rescue plan does not alter the rights of the holders of any class of the company's securities, preliminary approval constitutes final approval. If the business rescue plan does alter the rights of any class of holders of the company's securities, the holders of these securities are called to a vote where the majority of the holders of the voting interest can approve the plan.[358]

Any affected person, or combination of affected persons, may make a binding offer to purchase the voting interests of one or more persons who opposed adoption of the business rescue plan, at a value independently and expertly determined on the request of the practitioner to be a fair and reasonable estimate of the return to that person, or those persons, if the company were to be liquidated.[359]

The adopted business rescue plan is binding on the company, on each creditor of the company and every holder of the company's securities, whether or not such a person was present at the meeting, voting in favour of the adoption of the plan, or in the case of creditors proven their claims against the company.[360] A so-called "cramdown" thus occurs where creditors are forced to accept the business rescue plan – even against their wishes. The business rescue may thus proceed despite objections by disgruntled creditors and the legislator did not deem it fit to provide a disgruntled party with a judicial remedy to seek to set aside the adoption of a business rescue plan.[361] Creditors are not divided into, nor do they vote, in classes.

The Companies Act 2008 provides that the process of business rescue involves "a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity…".[362] The business rescue plan may expressly include a proposal, including the extent to which the company is to be released from the payment of its debts and the extent to which any debt is proposed to be converted to equity in the company, or another company.[363]

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[355] *Idem*, s 150(2).
[356] *Idem*, s 150(5). The court or the holders of the majority of the creditors' voting interest may also allow for a longer period than 25 days.
[357] *Idem*, s 152(2). Also see s 145(5).
[358] *Idem*, s 152(3)(c).
[359] See *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and Others* 2013 (6) SA 471 (GNP) and *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* 2014 (1) SA 103 (KZP).
[360] Companies Act 2008, s 152(4).
[361] See *Compare Stalcor (Pty) Ltd v Kritzinger NO* (1841/2012) [2016] FB (21 January 2016) par 44; *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd (Advantage Projects Managers (Pty) Ltd Intervening* 2011 (5) SA 600 (WCC) par 74 and *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and Others* 2013 (6) SA 471 (GNP) par 59.
[362] Companies Act 2008, s 128(1)(b)(iii).
[363] *Idem*, s 150(2)(b)(ii).

6.5.8 Contracts

Executory contracts are not automatically terminated upon the commencement of business rescue proceedings. Except for certain contracts, the treatment whereof provided for in the Companies Act 2008 and the Insolvency Act,[364] the business rescue practitioner may elect to either entirely, partially or conditionally suspend obligations of the company, or cancel the executory contract in question by means of obtaining a court order.[365] The obligations which may be suspended by the business rescue practitioner for the duration of the proceedings relate to obligations of the company that would become due during the business rescue proceedings. The Companies Act 2008 does not prescribe any time periods within which the business rescue practitioner should exercise this suspension right, but as an obligation must be suspended before it becomes due, a proactive approach is required.[366]

It has been submitted that this suspension right of the business rescue practitioner does not have much practical effect. Contract law is based on reciprocity and where the business rescue practitioner elects to withhold performance, the other contracting party may do the same.[367] Before a business rescue practitioner elects to suspend obligations due under an executory contract, a creditor may also cancel such an agreement.[368] Onerous contracts may only be cancelled by means of a court order.[369]

The treatment of the following contracts are specifically provided for and the business rescue practitioner may not elect to simply suspend obligations:

Employment contracts

During business rescue proceedings, employees of the company continue to be employed on the same terms and conditions as immediately before the proceedings except to the extent that changes occur in the ordinary course of attrition, or the employees and the company agree upon different terms and conditions in accordance with applicable labour laws.[370]

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[364] Exceptions provided for are employment contracts and agreements on a securities exchange. These exceptions are discussed below.

[365] Companies Act 2008, s 136(2)(a) and (b).

[366] Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Van der Linde (eds) *Treatment of Contracts in Insolvency* (Oxford University Press 2013) 365 372.

[367] *BP Southern Africa (Pty) Ltd v Intertrans Oil SA (Pty) Ltd and Others* (34716/2016) [2016] ZAGPJHC 310; 2017 (4) SA 592 (GJ) (25 November 2016). Also see Lawrenson "Lease agreements and business rescue: in need of rescue?" 2018 *Tydskrif vir die Suid-Afrikaanse Reg* (TSAR) 657 and Calitz and Lawrenson "Lessons to be learnt from Germany regarding the treatment of executory contracts when a debtor company is being restructured: a South African perspective" in Hugo and Möllers (eds) *Transnational Impacts on Law: Perspectives from South Africa and Germany* (2017) 151 176.

[368] *Cloete Murray NO & another v FirstRand Bank Ltd* [2015] ZASCA 39 (26 March 2015). Also see the discussion on the moratorium above.

[369] For criticism on the current South African position, see Lawrenson "Lease agreements and business rescue: in need of rescue?" 2018 *Tydskrif vir die Suid-Afrikaanse Reg* (TSAR) 657.

[370] Companies Act 2008, s 136(1)(a). In accordance with s 136(1)(b), any retrenchments (redundancies) contemplated in a business rescue plan are subject to ss 189 and 189A of the Labour Relations Act 66 of 1995 and other applicable labour legislation. See also *South African Airways SOC Ltd (in business rescue) and Others v National Union of Metalworkers and Others* 2021 (2) SA 260 (LAC) in this regard.

Contracts on a securities exchange

Transactions on exchanges and market agreements on informal markets[371] are not affected by the opening of business rescue proceedings, and will continue to operate unless the agreement in question provides otherwise. These agreements may not be suspended by the business rescue practitioner and may further also not be cancelled by the court.

The position regarding set-off under these contracts is problematic. Under South African law set-off is regarded as a method of discharging a payment obligation and arises automatically by operation of law. The moratorium provided for under business rescue proceedings appears to regard set-off as a form of enforcement action or legal proceeding and provides for an exception regarding set-off against a claim of the company in legal proceedings.[372] It is impractical that set-off depends on the consent of the business rescue practitioner or the court. As there are no provisions regarding impeachable dispositions,[373] no exceptions for financial contracts are required.[374]

Essential contracts

There are no provisions for the treatment of essential contracts.[375] It is interesting to note that the legislator has published the Companies Amendment Bill and has included a proposed amendment to section 135 of the Companies Act 2008, which will deal with the landlord's claim for rent falling due in business rescue. [376] The current position is that the landlord's claim for rent falling due in business rescue (based on an executory lease agreement) is neither "financing" nor is it "costs of the business rescue proceedings"[377] and is therefore not a preferential claim.[378] The proposed amendment to the Companies Act will see such a landlord's claim dealt with as post-commencement financing, which will place a landlord in a better position than is currently the case. This may prove to be a positive step towards amendments needed for the treatment of essential contracts.

6.5.9 Impeachable transactions

There are no provisions for the setting aside of impeachable dispositions under business rescue proceedings.[379]

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[371] Insolvency Act, ss 35A and 35B respectively.
[372] Companies Act 2008, s 133(1)(c).
[373] See the discussion on impeachable dispositions below.
[374] See the discussion in Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Van der Linde (eds) *Treatment of Contracts in Insolvency* (Oxford University Press 2013) 365 396 to 396.
[375] For criticism on the current South African position, see Lawrenson, "Lease agreements and business rescue: in need of rescue?" 2018 *Tydskrif vir die Suid-Afrikaanse Reg* (TSAR) 657.
[376] *Government Gazette* 41913 (21 Sept 2018). Specifically see the proposed s 19, which will amend s 135.
[377] As contemplated in ss 135(2) and 135(3) of the Companies Act 2008 respectively.
[378] *South African Property Association v Minister of Trade and Industry* (66068/2016) 2016 ZAGPPHC 1148 (29 November 2016).
[379] Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Van der Linde (eds) *Treatment of Contracts in Insolvency* (Oxford University Press 2013) 365 396. Section 141(2)(c)(i) simply states that if there is evidence of any impeachable transactions before the commencement of the business rescue proceedings, the

6.5.10 Directors' liability

If, in investigating the affairs of the company the business rescue practitioner finds evidence of failure by any director to perform any material obligation relating to the company, the business rescue practitioner must take any necessary steps to rectify the matter, and may direct the management to take appropriate steps.[380] It must be borne in mind that business rescue proceedings are regulated by the Companies Act 2008 and the liquidation of insolvent companies by the Companies Act 1973.[381] Under business rescue proceedings the directors of a company are thus not subject to any of the provisions of the Companies Act 1973. Whilst the company is under business rescue, a director remains bound by the duty to disclose personal financial interests or those of a related person,[382] but is relieved from the duties of a director set out in section 76 and from most liabilities under section 77 of the Companies Act 2008, provided he acts under the authority and according to the instructions or direction of the business rescue practitioner.[383] The liabilities for which a director remains liable under section 77 are in respect of loss sustained by the company as a result of:

- acting on behalf of the company despite knowing that he lacks authority;[384]
- acquiescing in the carrying on of the company's business despite knowing that it is being conducted recklessly, with gross negligence or with intent to defraud or for a fraudulent purpose;[385] and
- being a party to an act or omission knowing that it is calculated to defraud a creditor, employee or shareholder or the company or that it has another fraudulent purpose.[386]

There is nothing that prevents the appointment of the same business rescue practitioner to different companies that are associated with each other.[387]

There are no special provisions or procedures for reorganisation in small to medium enterprises.

business rescue practitioner needs to take the necessary steps to rectify the matter. These "necessary steps" are not prescribed and no sanction is provided should the practitioner not do so.

380 Companies Act 2008, s 141(2)(c)(i).

381 As discussed above in para 6.3.

382 Companies Act 2008, ss 75 and 137(2)(c).

383 *Idem*, s 137(2)(d).

384 *Idem*, s 77(3)(a).

385 *Idem*, s 77(3)(b) read with s 22(1).

386 *Idem*, s 77(3)(c).

387 Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Richter (eds) *Commencement of Insolvency Proceedings* (Oxford University Press 2012) 521 549.

Self-Assessment Exercise 5

Study the basic aspects dealt with in the previous section.

Question 1

Explain how and by whom a business rescue plan is adopted, and why, in certain instances, there is preliminary approval first.

Question 2

Write a note on the principles applicable to the treatment of executory contracts in business rescue proceedings, including any relevant ancillary factors that, in your opinion, the business rescue practitioner may need to take into consideration before exercising any right of election.

For commentary and feedback on self-assessment exercise 5, please see APPENDIX A

7. CROSS-BORDER INSOLVENCY LAW

The South African legislature implemented a version of the UNCITRAL Model Law on Cross-Border Insolvency[388] by means of the Cross-Border Insolvency Act 42 of 2000,[389] which was implemented on 28 November 2003. One of the main aims of the Cross-Border Insolvency Act is to provide for easy and speedy access and recognition of foreign representatives or creditors, while retaining measures to curb abuse. This Act provides for equal treatment of ordinary creditors, whether local or foreign, but safeguards the rights of local secured and preferent creditors.[390] The Cross-Border Insolvency Act is in force, but will only become effective once states have been designated in terms of this Act,[391] which to date has not yet been done. The most substantial difference between the Cross-Border Insolvency Act and the Model Law is that the Act requires reciprocity.[392] The Act will apply in respect of states designated by the minister responsible for the administration of justice and the minister may only designate a state if satisfied that the recognition accorded by the law of such a state to proceedings under the laws of South Africa relating to insolvency justifies the application of the act to foreign proceedings in such a state.[393] The minister has not designated any states and it seems that designation

[388] Hereafter the "Model Law".
[389] Hereafter the "Cross-Border Insolvency Act".
[390] Cross-Border Insolvency Act, s 13(2), provides that the recognition of foreign proceedings does not affect the ranking of claims in proceedings under South African law relating to insolvency.
[391] Cross-Border Insolvency Act, s 2(2) to (5).
[392] The Model Law has not been totally incorporated by reference – it was necessary to keep the Cross-Border Insolvency Act in line with existing South African laws on insolvency. See Van Zuylen, "South Africa and OHADA member states" in Chan Ho (ed), *Cross-Border Insolvency – A commentary on the UNCITRAL Model Law* (4th edition, Globe Law and Business 2017) 557 557. Also see the discussion below on how the Cross-Border Insolvency Act differs from the Model Law.
[393] Cross-Border Insolvency Act, s 2.

(which must be tabled in Parliament) is not imminent.[394] At present the South African law on cross-border insolvency is controlled by common law principles,[395] which follows a blend of both the universalist and the territorialist theories to cross-border insolvency.[396]

Whether the foreign representative may deal with South African assets is a question determined by a division of types of property[397] and the classification of persons. Movable property is governed by the law of the natural person's domicile (*lex domicilii*). The debtor declared insolvent by the court of his domicile is thus, by a fiction, automatically divested of his movables throughout the world and therefore in South Africa.[398] Although it is therefore not strictly speaking necessary based on legal principle, the foreign representative would still be prudent in seeking recognition from the South African courts before dealing with local assets, as the court has held that "[a]s a matter of practice, however, such an application is invariably made and the need for formal recognition has been elevated into a principle".[399] In the case of a company, the place of incorporation may be substituted for the place of domicile,[400] but the principal place of business may afford jurisdiction even if the place of the registered office is elsewhere.[401] The representative of a debtor that is a juristic person is obliged to seek such recognition[402] and has no authority to deal with South African assets until such recognition has been granted.[403] He must show that he was appointed where the company is registered or has its principal place of business and that his claim is genuine. Whether such appointment is valid is a decision, not for the South African court in granting recognition, but in proceedings that such representative may bring after he has been recognised. Immovable property is governed by the law of the place where the immovable property is situated (*lex situs*), regardless of whether the debtor is an individual or a juristic person.[404] The sequestration of an estate outside South Africa does not divest the insolvent of immovable property situated in South Africa.[405]

A foreign officeholder seeking recognition in South Africa must apply to the High Court in this regard. The High Court will grant a rule *nisi* to issue and publish the application, calling on all persons concerned to show any cause against the granting of the application,[406] but on several

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394 *Ex parte van Straten* (22678/14) [2014] WCC (19 December 2014). The Cross-Border Insolvency Act has been in force for more than 15 years without any states being designated by the Minister.

395 Sharrock, Van der Linde and Smith, *Hockly's Insolvency Law* (9th edition, Juta 2012) 298.

396 Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 660.

397 This division is not present in the Cross-Border Insolvency Act.

398 See the discussion on divesting of assets in para 6.2 above. See also see *Viljoen v Venter NO* 1981 (2) SA 152 (W).

399 *Ex parte Palmer: In re Hahn* 1993 (3) SA 359 (C). See specifically para 362E of the judgment.

400 *Idem*, para 364E.

401 *Ex parte LaMonica v In re Eastwind Development SA (Baltic Reefers Management Ltd intervening)* 2011 (3) SA 164 (WCC).

402 *Ward and another v Smit and others: In re Gurr v Zambia Airways Corporation Ltd* 1998 (3) SA 175 (SCA) and *LaMonica v Baltic Reefers Management Ltd* 2011 (3) SA 164 (WCC) 167). As a company is not divested of its assets upon liquidation, a foreign officeholder will also have to apply for recognition in respect of movable assets. See the discussion in para 6.3 above.

403 *In re O'Connell, Ex parte Pooley* 10 SC 62.

404 *Ex parte BZ Stegmann 1902 TS 40 47–8; Moolman v Builders & Developers (Pty) Ltd (in Provisional Liquidation): Jooste intervening* 1990 (1) SA 954 (A).

405 *Deutsche Bank AG v Moser* 1999 (4) SA 216 (C) 219J.

406 It has been suggested that such a rule *nisi* should be issued if the debtor has South African creditors and that if the foreign trustee seeks recognition, the insolvent should be allowed a hearing unless the insolvent does not intend opposing the proceedings of which he is aware; see *Priestley v Clegg* 1985 (3) SA 955 (T).

occasions the court has granted the final recognition order without issuing a rule *nisi*.[407] In the order the court will impose conditions for the protection of local creditors, which will ensure that the estate as a whole is divided equally and that dividends due to local creditors are paid out of local assets, if sufficient.[408] The court order is endorsed by the Master if satisfied that the foreign officeholder has furnished appropriate security, amongst others.[409] The court order must be published in the *Government Gazette* and in one or more South African newspapers.[410] After payment of the various charges, costs and proved claims, any remaining assets and moneys may be removed from South Africa only with the written consent of the Master or with the consent of the court.[411]

Contrary to the practice in many foreign jurisdictions, the foreign officeholder is recognised in South Africa and not the foreign insolvency proceedings.[412] In general, a foreign bankruptcy order has no influence on proceedings in South Africa. However, it is generally considered desirable that there should be a single insolvency proceeding. The court has on the application of a foreign officeholder set aside a local winding-up order granted *ex parte* where the local applicant failed to disclose that it was incorporated in a foreign country where it had already been placed in voluntary liquidation.[413] The Insolvency Act provides that when it appears to the court to be equitable and convenient that the estate of a person domiciled in a state which has not been designated in terms of section 2 of the Cross-Border Insolvency Act should be sequestrated by a court outside South Africa, the court may refuse or postpone the issue of a sequestration order.[414]

The South African courts may be persuaded by the following factors when exercising their discretion whether to recognise foreign proceedings:[415]

Equitable and convenient if insolvent is resident outside South Africa

The court would more readily exercise its discretion and refuse to grant a sequestration order on the ground that it would be equitable or convenient for the estate to be sequestrated elsewhere, if the respondent was not found to have been resident within the jurisdiction of the court.[416]

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[407] *Priestley v Clegg* 1985 (3) SA 950 (W), para 954E-F.

[408] *Ward v Smit: In re Gurr v Zambia Airways Corp Ltd* 1998 (3) SA 175 (SCA) 179G-I.

[409] *Ex parte Gettliffe: In re Dominion Reefs (Klerksdorp) Ltd (in liquidation)* 1965 (4) SA 75 (T) at 78A-B.

[410] *Ex parte Steyn* 1979 (2) SA 309 (O) at 312D.

[411] See *Ex parte Steyn* 1979 (2) SA 309 (O) and *In re Melliar, Smith & Co, Ex parte Hooper* 1922 CPD 116 par 184.

[412] Foreign proceedings have however been recognised by South African courts. In the unreported matter of *Overseas Shipholding Group, Inc and 180 others*, High Court of South Africa, KwaZulu-Natal Division, case reference 12827/12, the court granted an order recognising an order granted by the US Bankruptcy Court, District of Delaware, ordering specifically that the automatic stay and related provisions of s 362 of the US Bankruptcy Code would apply of full force and effect in South Africa in regard to the applicants and any assets of any applicant in South Africa or its territorial waters at any time.

[413] *In re Leydsdorp & Pietersburg Estates Ltd (in liquidation)* 1903 TS 254.

[414] Insolvency Act, s 149.

[415] In exercising its discretion, territoriality remains largely the norm applied by the South African courts. See Boraine, "Comparative Notes on the Operation of Some Avoidance Provisions in a Cross-Border Context" 2009 *South African Mercantile Law Journal* (SA Merc LJ) 463.

[416] *Nahrungsmittel Gmbh v Otto* 1991 (4) SA 414 (C).

Preference for single proceeding directed by court of domicile

It is most convenient that a matter be adjudicated upon by a South African court if a debtor has virtually no assets outside South Africa and his only asset in South Africa is immovable property; where an officeholder has not been appointed in a foreign country and application has not been made for recognition in South Africa.[417] Several cases expressed a preference for a single forum of administration. The general rule is that the court of the domicile[418] should direct the main sequestration and that all other decrees should be ancillary or subsidiary.[419] A winding-up order has been refused where a single liquidation order would be more convenient and the interests of local creditors would be as well protected in the foreign proceedings as if a local winding-up order had been granted.[420] In *Ward v Smit: In re Gurr v Zambia Airways Corp Ltd*[421] the court expressed a preference for a single *concursus creditorum*,[422] but refused recognition because application was not made timeously. It was decided in terms of the Companies Act 1973[423] that a South African court had jurisdiction to grant a winding-up order in respect of an external company notwithstanding that it was the subject of a voluntary or compulsory winding-up in the country of its incorporation.[424]

Assets in South Africa not a prerequisite for recognition

In *Moolman v Builders & Developers (Pty) Ltd*[425] the foreign officeholder was authorised to hold an enquiry into the affairs of the insolvent or company in terms of South African law even though the insolvent or company did not have any assets in South Africa.[426]

If order was granted by the court of domicile and the insolvent has movables only it is a mere formality, but for immovable property the court will apply its discretion

The question whether the bankruptcy order was granted by the debtor's court of domicile is an important consideration. If under such circumstances only movables of the debtor are situated in South Africa, the recognition order may be a mere formality. A discretion is, however, exercised if immovable property of the debtor is located in South Africa. There must be exceptional circumstances and considerations of convenience before foreign proceedings will be recognised if the foreign order was not granted by the court of domicile.[427]

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417 *Deutsche Bank AG v Moser* 1999 (4) SA 216 (C) 219H-220C.

418 In *Lehane NO v Lagoon Beach Hotel (Pty) Ltd* 2015 (4) SA 72 (WCC), paras 55 and 56, the court noted that domicile of the insolvent in a country was not an absolute requirement for recognition.

419 *Re Estate Morris* 1907 TS 657 at 668.

420 *Donaldson v British South African Asphalt and Manufacturing Co Ltd* 1905 TS 753 and *In re Leydsdorp & Pietersburg Estates Ltd (in liquidation)* 1903 TS 254.

421 1998 (3) SA 175 (SCA) 179G.

422 See the discussion on the *concursus creditorum* in note 164 above.

423 Companies Act 1973, s 344(g).

424 *Ward v Smit: In re Gurr v Zambia Airways Corp Ltd* 1998 (3) SA 175 (SCA) 183H.

425 1990 (1) SA 954 (A).

426 Enquiries are regulated in terms of s 65 of the Insolvency Act for sequestration proceedings, and ss 415 to 417 of the Companies Act 1973 for liquidation proceedings. A discussion on enquiries do no fall within the scope of this guidance text.

427 See *Ex parte Palmer: In re Hahn* 1993 (3) SA 359 (C) and *Lagoon Beach Hotel v Lehane* (235/2015) [2015] ZASCA 210 (21 December 2015) par 31.

A foreign bankruptcy order or the recognition of a foreign officeholder by a South African court does not make the debtor an insolvent in South Africa.[428] The qualifications of a foreign officeholder are decided according to the law of the country where he was appointed and not according to the law of the country where his appointment is recognised.[429]

The recognition order is a declaratory order regarding the foreign officeholder's entitlement, subject to local requirements, to administer the assets as though they were in the relevant foreign jurisdiction from which he derives his authority.[430] The foreign officeholder will have to request the court grant him the necessary powers that will enable him to administer the property situated in the court's jurisdiction. An example of the type of order which the court may grant when a foreign officeholder applies for recognition is to be found in *Moolman v Builders & Developers (Pty) Ltd*.[431] The rights defined by South African insolvency law (and if applicable, company law) in favour of the Master, a creditor, and an insolvent or company being wound up, in regard to:

- meetings of creditors;
- proof, admission and rejection of claims;
- sale of assets;
- plans of distribution of proceeds; and
- the rights and duties of a trustee or liquidator concerning those matters,

exist in relation to the administration as if the law applied thereto pursuant to a sequestration or winding-up order granted on the date of the recognition order. It is usually provided that the applicant provide security for the proper performance of the administration; that the order of recognition is subject to amendment by the court; that the applicant should comply with the provisions for the opening and operation of banking accounts; and that funds may be transferred out of South Africa with the written permission of the Master.

Lehane NO v Lagoon Beach Hotel (Pty) Ltd[432] provides another example of the type of order which the court may grant when a foreign officeholder applies for recognition. The foreign representative was empowered, after providing security to the satisfaction of the Master:

- to administer the estate of the insolvent in respect of all his assets which are or may be found or are situated within South Africa;
- with all rights under the Insolvency Act, including sections 64 (insolvent and others to attend meetings of creditors), 65 (interrogation of insolvent and other witnesses), 66 (enforcing

[428] See *Herman v Tebb* 1929 CPD 65 at 76 and *Chaplin v Gregory* 1950 (3) SA 555 (C) 562A-B.
[429] *Ex parte Robinson's Trustee* 1910 TPD 25.
[430] Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 664.
[431] 1990 (1) SA 954 (A).
[432] 2015 (4) SA 72 (WCC) par 7.

summonses and giving of evidence), 69 (trustee must take charge of property of estate) and 82 (sale of property after second meeting and manner of sale); and

- to administer the estate of the insolvent as if a sequestration order had been granted against him by a South African court.

South Africa's non-statutory procedure has been fashioned by the courts on the strength of common law authority. Considerations of comity, convenience and equity play an important role in the exercise of the discretion of the court to recognise a foreign officeholder.[433] In *Society of Lloyd's v Romahn and two other cases*[434] the court held that comity is not applied, though, if it conflicts with public policy. In *Ex parte LaMonica v In re Eastwind Development SA (Baltic Reefers Management Lth intervening)*[435] the application was for the recognition by the South African court of a foreign representative to enable him to pursue certain claims in South Africa. The applicant was appointed by the United States Bankruptcy Court of the Southern District of New York as bankruptcy trustee of a Panamanian company. The court held that a foreign officeholder required recognition by an order of a South African court before the foreign officeholder was entitled to deal with local assets and confirmed that the court exercises discretion and is guided by grounds of comity and convenience. The court further held that according to the information before it, it had no reason to believe that the applicant was not acting *bona fide* and that the applicant would fail in their duties if they did not pursue claims which he regarded as valid. Therefore the consideration of comity and convenience favoured the order sought by the applicant, and the application accordingly succeeded. Recognition of the foreign representative enables him to rely on domestic South African law in carrying out his duties.[436]

Although not yet effective, the Cross-Border Insolvency Act provides that with regard to access to South African courts the foreign officeholder may apply directly to our courts and in doing so does not automatically subject himself or the debtor's matters to this jurisdiction for other purposes.[437]

If a South African officeholder, such as a trustee or liquidator, seeks to pursue investigation and recovery processes outside South Africa, he may have to apply[438] to the High Court for "letters of request" recognising his appointment as a preparatory step for approaching the relevant foreign authorities.[439] The procedures that the officeholder will have to follow to deal with assets outside South Africa depend on the law and practice in the country where the assets are

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433 *Lehane NO v Lagoon Beach Hotel (Pty) Ltd* 2015 (4) SA 72 (WCC).

434 2006 (4) SA 23 (C).

435 [2010] JOL 24783 (WCC).

436 When the Cross-Border Insolvency Act takes effect, s 23 of that Act will grant a foreign officeholder standing to attack transactions in South Africa in terms of local insolvency laws.

437 Cross-Border Insolvency Act, s 9.

438 Whether or not "letters of request" are required to be filed with the relevant foreign court depends on the law and procedure of the foreign state in question; see Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 666 and 667.

439 A "letter of request" is a request by the local court to a foreign court to assist the South African officeholder. See *Lehane NO v Lagoon Beach Hotel (Pty) Ltd* 2015 (4) SA 72 (WCC) par 5 for a request by a foreign court for assistance of an Irish representative.

situated. In *Ex parte Wessels & Venter: In re Pyke- Nott's insolvent estate*[440] the court refused to issue an order requesting assistance from the courts of England because the applicants had not shown reasonable prospects of success that an examination in England would lead to the discovery of further assets. In *Gardener v Walters*[441] the court disagreed with this view and stated that it was sufficient if the liquidator was *bona fide* of the view that proceedings should be initiated in the foreign country, because when approached to issue a letter of request the court is not asked to approve or to sanction the actions of the liquidator.[442] In seeking these "letters of request", the officeholder thus need only hold the genuine belief that foreign proceedings should be initiated; he is not required to establish a *prima facie* case or prove a reasonable prospect of success in uncovering assets through foreign examination, in order to convince the South African court to grant him "letters of request".[443]

What happens when neither the foreign nor the South African officeholder applies for recognition of their respective appointments? In the recent case of *Sackstein NO v Proudfoot (Pty) Ltd*,[444] a Namibian company was registered in South Africa as an external company.[445] The Namibian company was liquidated on the grounds that it was unable to pay its debts and a liquidator was appointed first in Namibia and later in South Africa after the South African company was also liquidated on the same grounds. The Namibian liquidator did not apply for recognition in South Africa. The Namibian court sanctioned a scheme of arrangement under its local companies legislation, set aside the liquidation order and discharged the Namibian liquidator from office. The South African liquidator applied to have payments from the Namibian estate to a creditor resident in South Africa set aside as an impeachable disposition.[446] The trial court held that the liquidator could not proceed with the impeachment action, in essence holding that the dispositions occurred in Namibia and, accordingly, that the South African liquidator had no powers in respect thereto.[447] The appeal court set this decision aside and held that an external company may be wound up separately from its parent, but there was only one legal person (registered in two countries), despite independent liquidation proceedings in Namibia and South Africa.[448] The court noted that there might be seemingly irreconcilable conflicts between two liquidators and that a principle of demarcation would have to be developed.[449] In this case there was no conflict because of the discharge of the Namibian liquidator. The invalidation was purely an administrative process which did not present jurisdictional problems in this case where the High Court issued the winding-up order, the liquidator was duly and lawfully appointed and the defendant was domiciled within the

[440] 1996 (2) SA 677 (O).
[441] 2002 (5) SA 796 (C) 810H.
[442] *Cf Ex parte LaMonica v In re Eastwind Development SA (Baltic Reefers Management Ltd intervening)* 2011 (3) SA 164 (WCC) A 2011 (3) SA p164 where the court, while dealing with a request to recognise a foreign representative, decided that he court was not called upon to decide whether the claim which the foreign representative wished to pursue was indeed a valid claim as long as the representative acted in *bona fide* pursuit of its responsibilities.
[443] *Gardener and another v Walters and another NNO (In re Ex parte Walters and another NNO* 2002 (5) SA 796 (C) par 810–11.
[444] 2003 (4) SA 348 (SCA).
[445] In terms of s 323 of the Companies Act 1973 (which section has since been repealed by the Companies Act 2008).
[446] In terms of s 29 and 30 of the Insolvency Act read with s 340 of the Companies Act 1973. See the discussion on impeachable dispositions in paras 6.2 and 6.3 above.
[447] *Sackstein v Proudfoot SA (Pty) Limited* [2005] JOL 14088 (W).
[448] Para 360F-G of the judgment.
[449] Para 357F-H of the judgment.

jurisdiction of the court. The court held that the South African liquidator had a choice either to apply for recognition in Namibia and to prosecute the impeachment and recovery process in that country; or to proceed under section 391 of the Companies Act 1973 to recover and reduce into possession all the assets and property of the company wherever situated.[450] If the liquidator succeeded in impeaching the transaction and if the property was outside South Africa, the liquidator had to seek recognition in the foreign country of the court order obtained in South Africa setting the transaction aside.[451]

Once the Cross-Border Insolvency Act becomes effective, it will substantially change the current common law position discussed in this guidance text.[452] The Cross-Border Insolvency Act differs from the Model Law in the following respects:

- it requires reciprocity;[453]
- the exclusion of application (for example banks or insurance companies) has not been included;[454]
- more definitions than contained in the Model Law have been included in the Cross-Border Insolvency Act, but it does not result in this Act differing substantially from the Model Law;[455]
- provision is made that a foreign creditor's claim, while recognised in a South African liquidation or sequestration, enjoys only such preference as it would if it were a South African claim;[456]
- the word "substantially" has been omitted from section 18 (entitled "Subsequent information" and providing that the foreign representative needs to inform the South African court of certain aspects), which incorporates article 18 of the Model Law;[457]

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[450] Para 369B-D of the judgment.

[451] Para 360E-F of the judgment.

[452] The common law position will of course still apply to countries not designated by the Minister responsible for the administration of justice. One result of such a dualistic system will be that, under the Cross-Border Insolvency Act, creditors from designated states will rank no lower than South African concurrent creditors; but under South African common law, creditors from non-designated countries will rank after the South African concurrent creditors and the creditors from designated countries (Bertelsmann *et al*, *Mars – The Law of Insolvency in South Africa* (9th edition, Juta 2008) 679 and 680).

[453] See the discussion above.

[454] Section 2 of the Cross-Border Insolvency Act enacts article 1 of the Model Law and does not contain this exclusion.

[455] The definitions contained in art 2 of the Model Law have been included in s 1 of the Cross-Border Insolvency Act. The terms "curator" and "receiver" are defined with reference to South African legislation, as these terms do not have a universally understood meaning within the South African context of insolvency. See Van Zuylen, "South Africa and OHADA member states" in Chan Ho (ed) *Cross-Border Insolvency – A commentary on the UNCITRAL Model Law* (4th edition, Globe Law and Business 2017) 557 560.

[456] Article 13 of the Model Law has been enacted by s 13 of the Cross-Border Insolvency Act. If art 13 of the Model Law remained unamended in this regard, it could create a situation where a foreign creditor's claim was granted preference to a local creditor's claim, even though the foreign creditor's claim was not recognised as preferent under South African law. A foreign creditor would thus be advised to take advice from a South African insolvency attorney as to whether the preference which it enjoys in its country would be recognised as such in South Africa.

[457] This means that a foreign officeholder is under an obligation to inform the court promptly of any change in the status of the recognised foreign proceedings or the status of the foreign officeholder's appointment. The rationale

- the word "legal" has been inserted into section 20 (entitled "Effect of recognition of foreign main proceedings"), which substantially incorporates article 20 of the Model Law.[458] Section 20 has also been made subject to certain aspects of South African insolvency law;[459] and

- the word "legal" has been inserted before "actions" and "proceedings" into section 21 (entitled "Relief that may be granted upon recognition of foreign proceedings"), which substantially incorporates article 21 of the Model Law, to ensure that only legal actions and legal proceedings are stayed. A further provision[460] has been included which provides that "[w]ithout derogating from the application of the laws of the Republic generally, in granting relief under this section the court must indicate the laws of the Republic relating to administration, realisation or distribution of a debtor's estate in the Republic that will apply". The inclusion of this additional provision was to include a "catch-all" provision and they require the court to decide on various issues not otherwise covered by the Model Law.[461]

South Africa is not a party to an appropriate international legal convention or treaty on cross-border insolvency. Should South Africa become a party to such, its international obligations in terms thereof will take precedence over the Cross-Border Insolvency Act (once effective).[462]

behind the deletion is twofold – firstly, every change in the foreign proceeding or status of the foreign officeholder's appointment must be reported to court and, secondly, different interpretations of the word "substantial" could cause difficulties. See Van Zuylen, "South Africa and OHADA member states" in Chan Ho (ed) *Cross-Border Insolvency – A commentary on the UNCITRAL Model Law* (4th edition, Globe Law and Business 2017) 557 565.

458 This has been done to ensure that only legal actions and legal proceedings are stayed.

459 Section 20(1)(d) of the Cross-Border Insolvency Act provides that "section 21 of the Insolvency Act, 1936 (Act 24 of 1936), applies with regard to assets situated in the Republic to the same extent as it would have if the debtor had been sequestrated by a court." Section 21 of the Insolvency Act provides that where a sequestration order is granted against the estate of one spouse, all property of the solvent spouse is vested in the Master (and later in the duly appointed trustee) as if it were property of the sequestrated estate. It further shifts the burden of proof to oblige the solvent spouse to prove that assets do not belong to the insolvent spouse. See the discussion in Van Zuylen, "South Africa and OHADA member states" in Chan Ho (ed) *Cross-Border Insolvency – A commentary on the UNCITRAL Model Law* (4th edition, Globe Law and Business 2017) 557 and 566 to 568.

460 Cross-Border Insolvency Act, s 21(4).

461 The issues include the manner in which claims by foreign creditors are to be filed; whether the actions of the foreign representative are to be supervised (and if so, by whom and how); whether security is required to be lodged; whether and how meetings of creditors are to be held; the proof, admission and rejection of claims; how assets are to be sold; how the proceeds of the insolvent estate are to be distributed; and rights and duties generally of both local trustees and liquidators and foreign officeholders. Van Zuylen "South Africa and OHADA member states" in Chan Ho (ed) *Cross-Border Insolvency – A commentary on the UNCITRAL Model Law* (4th edition, Globe Law and Business 2017) 557 and 569.

462 Cross-Border Insolvency Act, s 3.

Self-Assessment Exercise 6

Question 1

Discuss whether recognition of the foreign officeholder of the estate of a natural person is required by a South African court in dealing with movable property of that debtor on the one hand and in dealing with his immovable property on the other hand.

Question 2

Write a short essay on the preference by South African courts: would a court rather recognise a foreign officeholder or recognise foreign proceedings? Discuss whether the courts have departed from this preference, and any further relevant considerations in this regard.

For commentary and feedback on self-assessment exercise 6, please see APPENDIX A

8. RECOGNITION OF FOREIGN JUDGMENTS

South Africa is not party to any treaty regarding the reciprocal enforcement of foreign commercial judgments.[463] The enforcement of foreign judgments is generally governed by common law and, in specific cases, by statute in terms of the Enforcement of Foreign Civil Judgments Act 32 of 1988.[464] This act currently applies to Namibia only and thus, until more countries are designated, the common law action will remain the only method for enforcing foreign judgments apart from civil matters which are governed by specific legislation.[465]

A foreign judgment is not directly enforceable in South Africa but establishes a course of action that will be enforced by South African courts if the following common law requirements are met:

- the foreign court must have had international competence as determined by South African law;[466]

[463] South Africa is therefore not a signatory to the Hague Convention on Recognition and Enforcement of Foreign Judgments in Civil and Commercial matters.

[464] Judgments to which this Act applies are enforced as if they were granted by a South African court. Other examples include the Reciprocal Enforcement of Maintenance Orders Act 80 of 1963, which provides for a special procedure that maintenance orders of a proclaimed country may be registered or confirmed in order to be recognised as a maintenance order under the South African Maintenance Act 99 of 1998. The Recognition and Enforcement of Foreign Arbitral Awards Act 40 of 1977 provides that a foreign arbitral award may be made an order of the High Court in South Africa and thereafter enforced in the same manner as a local judgment or order. See Theophilopoulos, Van Heerden and Boraine, *Fundamental Principles of Civil Procedure* (3rd edition, LexisNexis 2015) 429.

[465] See the discussion by Calitz and Harris in *INSOL International, Avoidance of Antecedent Transactions and Cross-Border Insolvency* (2016) p 255.

[466] These grounds include that the defendant must have been habitually resident, domiciled or present in the area of jurisdiction of the foreign court at the time of the commencement of the action; or the defendant must have submitted to the jurisdiction of the foreign court. See *Richman v Ben-Tovim* 2007 2 SA 283 (SCA).

- the judgment must be final and conclusive;
- the enforcement of the judgment must not be contrary to South African public policy or the concept of natural justice;
- the judgment must not have been obtained fraudulently;
- the judgment must not involve the enforcement of a penal or revenue law of the foreign state; and
- enforcement must not be prohibited by the Protection of Businesses Act 99 of 1978.[467]

A South African court will also take into account the principles of comity that exist between the states and whether it is just and equitable to recognise a judgment.[468]

In the unreported matter of *Overseas Shipholding Group, Inc and 180 others*,[469] the court granted an order recognising an order granted by the US Bankruptcy Court, Delaware, ordering specifically that the automatic stay and related provisions of section 362 of the US Bankruptcy Code would apply of full force and effect in South Africa in regard to the applicants and any assets of any applicant in South Africa or its territorial waters at any time. In another recent unreported matter based on similar facts, the High Court in *OXL NV*[470] recognised a foreign "business rescue" order made at the instance of the Commercial Court in Bruges. In both these cases the court recognised a foreign judgment on what appear to be considerations of South Africa's international obligations of comity and the objectives of the Cross-Border Insolvency Act.[471]

Self-Assessment Exercise 7

Study the basic aspects dealt with in the previous section.

Question 1

Discuss the common law principles applicable to the recognition of foreign judgments by a South African court.

For commentary and feedback on self-assessment exercise 7, please see APPENDIX A

[467] *Purser v Sales; Purser and Another v Sales and Another* 2001 (3) SA 445 (SCA).
[468] Theophilopoulos, Van Heerden and Boraine, *Fundamental Principles of Civil Procedure* (3rd edition, LexisNexis 2015) 428.
[469] High Court of South Africa, KwaZulu-Natal Division, case reference 12827/12. Also discussed above.
[470] High Court of South Africa, KwaZulu-Natal Division, case reference 1681/14.
[471] See the discussion by Calitz and Harris in *INSOL International, Avoidance of Antecedent Transactions and Cross-Border Insolvency* (2016) p 256.

9. INSOLVENCY LAW REFORM

In South Africa there is a highly fragmented approach to insolvency procedures. There is, *inter alia*, a lack of a unitary opening proceeding and the type of proceeding does not depend on whether or not the debtor conducts a business.[472] In 1987 the South African Law Reform Commission embarked on an investigation into the whole of South African insolvency law, which led to a variety of reports and eventually culminated in draft bills in both 1996 and 2000.[473] Although the idea of single statute was approved by the executive in 2003, no subsequent formal legislative efforts followed.[474]

The Department of Justice and Constitutional Development has an unofficial working document dated 30 June 2010 on insolvency law reform, namely the Bankruptcy and Business Recovery Bill which provides for the liquidation of all types of insolvent debtors, but retains a distinction between the grounds for liquidation of individuals and partnerships on the one hand, and those for corporate debtors on the other hand. Corporate rescue proceedings will also be provided for in this proposed new legislation (as far as it relates to non-company debtors), as well as the introduction of a pre- and post-liquidation composition for debtors other than companies, separate from the compromise procedure in the Companies Act 2008.[475] No formal legislative efforts have followed.[476]

10. USEFUL INFORMATION

Textbooks

- Kunst, Boraine and Burdette, *Meskin, Insolvency Law and its operation in winding-up* (LexisNexis loose-leaf Edition);
- Bertelsmann et al, Mars – *The Law of Insolvency in South Africa* (9th edition, Juta 2008);
- Sharrock, Van der Linde and Smith, *Hockly's Insolvency Law* (9th edition, Juta 2012);
- Faber, Vermunt, Kilborn and Richter (eds) *Commencement of Insolvency Proceedings* (Oxford University Press 2012);

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[472] Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Richter (eds) *Commencement of Insolvency Proceedings* (Oxford University Press 2012) 521 524.

[473] See Steyn, "Reform of South African Insolvency Law" 2001 (volume 10) *International Insolvency Review* 141.

[474] Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Richter (eds) *Commencement of Insolvency Proceedings* (Oxford University Press 2012) 521 522.

[475] This Bill is not yet in the public domain. Van der Linde, "National Report for South Africa" in Faber, Vermunt, Kilborn and Richter (eds) *Commencement of Insolvency Proceedings* (Oxford University Press 2012) 521, 522 and 526.

[476] For background on and proposals regarding insolvency law reform in South Africa, see Burdette *A framework for corporate insolvency law reform in South Africa* (2002 thesis UP). See also Boraine and Roestoff, "Revisiting the State of Consumer Insolvency in South Africa after Twenty Years: The Courts' Approach, International Guidelines and an Appeal for Urgent Law Reform" Part 1 2014 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg / Journal of Contemporary Roman-Dutch Law* (THRHR) 352 and Boraine and Roestoff, "Revisiting the State of Consumer Insolvency in South Africa after Twenty Years: The Courts' Approach, International Guidelines and an Appeal for Urgent Law Reform" Part 2 2014 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg / Journal of Contemporary Roman-Dutch Law* (THRHR) 527.

- Faber, Vermunt, Kilborn, Richter and Tirado (eds) *Ranking and Priority of Creditors* (Oxford University Press 2016);

- Faber, Vermunt, Kilborn and Van der Linde (eds) *Treatment of Contracts in Insolvency* (Oxford University Press 2013.

Websites

- South African Restructuring and Insolvency Practitioners Association: https://www.saripa.co.za/;

- Turnaround Management Association Southern Africa: https://www.tma-sa.com/;

- Companies and Intellectual Properties Commission: http://www.cipc.co.za/za/;

- The Master of the High Court: https://www.justice.gov.za/master/insolvency.html;

- Case law: http://www.saflii.org/.

APPENDIX A: COMMENTARY AND FEEDBACK ON SELF-ASSESSMENT EXERCISES

Self-Assessment Exercise 1

Study the basic aspects dealt with in the previous section.

Question 1

Write a short essay on the regulation of insolvency practitioners in South Africa.

Commentary and Feedback on Self-Assessment Exercise 1

Question 1

In your essay the following should be addressed: whether there is a formal insolvency regulator in South Africa; a discussion of the role of the Master of the High Court and some of the functions allocated to the Master; the proposed ministerial policy; and in brief a discussion of the conclusion of all three courts in the *South African Restructuring and Insolvency Practitioners Association v The Minister of Justice and Constitutional Development* matter. You may also briefly mention the role of SARIPA.

Self-Assessment Exercise 2

Study the basic aspects dealt with in the previous section.

Question 1

Provide an overview of the various ways in which a creditor can be a secured creditor and enjoy preference in terms of the Insolvency Act.

Commentary and Feedback on Self-Assessment 2

Question 1

In this instance you should be able to discuss the various types of real security available to a creditor – special mortgage in all its forms; pledge (including a cession made *in securitatem debiti*); hypothec (including both that of a landlord and in terms of the National Credit Act); and a right of retention.

Self-Assessment Exercise 3

Study the basic aspects dealt with in the previous section.

Question 1

Who may be considered a "debtor" in terms of section 2 of the Insolvency Act?

Question 2

Write a short note on what is meant by "advantage to creditors", and upon whom this burden of proof rests.

Commentary and Feedback on Self-Assessment Exercise 3

Question 1

- a natural person;
- a partnership (even if all the members are juristic persons);
- a deceased estate and an insolvent debtor incapable of managing his own affairs;
- an external company that does not fall within the definition of "external company" in the Companies Act 1973; and
- an entity or association of persons that is not a juristic person, such as a trust.

Question 2

Although there is no threshold for entering bankruptcy proceedings, there is a requirement as to "advantage to creditors". Under voluntary surrender the debtor has to prove that there *will* be advantage to creditors if the sequestration order is granted; and under compulsory application the sequestrating creditor needs to prove that there is *reason to believe* that the order will be to the advantage of creditors. The onus on proving advantage when applying for compulsory sequestration is less strict than under voluntary surrender, and there must be a reasonable prospect – not necessarily a likelihood, but a prospect which is not too remote – that sequestration will be to the advantage of creditors. For sequestration to be to the advantage of creditors it must "yield at the least, a not negligible dividend". Various divisions of the High Court differ on what constitutes a sufficient or non-negligent dividend, but in general advantage to creditors will be present if there is a reasonable and not too remote prospect of some pecuniary benefit to creditors.
You may also refer to case law in your answer.

Self-Assessment Exercise 4

Study the basic aspects dealt with in the previous section.

Question 1

Company A, Company B and Company C all form a group of companies, and are all unable to pay their respective debts. With reference to case law, what principles regarding the opening of insolvency proceedings may find application to such a group of companies?

Commentary and Feedback on Self-Assessment 4

Question 1

A single application may not be used to apply for the liquidation of a group of companies, except possibly, with the consent of all interested persons or where there is a complete identity of interests as between the companies concerned. In *Cooper NO v Micromatica 324 (Pty) Ltd* ((41820/2015) [2016] WCC (10 October 2016)) the court simultaneously with the liquidation orders for three companies declared the three companies a single entity as envisaged by, amongst others, section 20(9) of the Companies Act 2008. If associated companies are being liquidated, the same liquidator is usually appointed to the different entities. This assists the liquidator in understanding the dynamics and detecting unjustified intra-group transactions.

Self-Assessment Exercise 5

Study the basic aspects dealt with in the previous section.

Question 1

Explain how and by whom a business rescue plan is adopted, and why, in certain instances, there is preliminary approval first.

Question 2

Write a note on the principles applicable to the treatment of executory contracts in business rescue proceedings, including any relevant ancillary factors that, in your opinion, the business rescue practitioner may need to take into consideration before exercising any right of election.

Commentary and Feedback on Self-Assessment Exercise 5

Question 1

A business rescue plan is adopted on a preliminary basis by creditors if it is supported by 75% of voting interests and 50% of independent creditors' voting interest (if any). Preliminary approval exists to afford the holders of any class of the company's securities the opportunity to have input in the plan in the event that the proposed plan will alter their rights. If the business rescue plan does not alter the rights of the holders of any class of the company's securities, preliminary approval constitutes final approval. If the business rescue plan does alter the rights of any class of holders of the company's securities, the holders of these securities are called to a vote where the majority of the holders of the voting interest can approve the plan.

Question 2

The following should be made mention of in your note: whether executory contracts are affected by the opening of business rescue proceedings or not; the suspension right afforded to the business rescue practitioner and what this right entails; whether the business rescue practitioner may reject an onerous contract or not; and any exceptions applicable to the statutory provisions. You may mention that the business rescue practitioner needs to take a proactive approach, but that due to the principle of reciprocity the business rescue practitioner may want to take into consideration, for example, whether the other contracting party's performance will be essential to the rescue of the company and based thereon perhaps elect not to suspend obligations. You may further mention whether the suspension right has much practical effect or not.

Self-Assessment Exercise 6

Question 1

Discuss whether recognition of the foreign officeholder of the estate of a natural person is required by a South African court in dealing with movable property of that debtor on the one hand and in dealing with his immovable property on the other hand.

Question 2

Write a short essay on the preference by South African courts: would a court rather recognise a foreign officeholder or recognise foreign proceedings? Discuss whether the courts have departed from this preference, and any further relevant considerations in this regard.

Commentary and Feedback on Self-Assessment Exercise 6

Question 1

Your discussion should include the following:

Movable property is regulated by the place where the debtor is domiciled (*lex domicilii*) and in accordance with South African law a debtor is automatically divested of his movable assets upon the granting of a sequestration order in the foreign country, which means that the debtor is also divested of all movable property in South Africa. Strictly speaking it is not necessary for a foreign officeholder to obtain recognition under these circumstances, but it is prudent to do so as it has become principle in practice. You may also refer to any relevant case law in your answer.

Immovable property is regulated by the place where the property is situated (*lex situs*) and as such the sequestration of an estate outside South Africa does not divest the insolvent of immovable property situated in South Africa. The foreign officeholder will have to apply for recognition.

Conclusion: recognition of the foreign officeholder will be required in order to deal with both movable and immovable assets of the natural person debtor in question.

Question 2

Your essay should make mention of the following: that as a general rule courts recognise a foreign officeholder and not foreign proceedings; and a recent exception and what the court ordered in respect of the foreign proceeding in question. You should further also discuss and briefly elaborate on the factors that a court may take into account when considering whether to recognise the foreign proceedings.

Self-Assessment Exercise 7

Study the basic aspects dealt with in the previous section.

Question 1

Discuss the common law principles applicable to the recognition of foreign judgments by a South African court.

Commentary and Feedback on Self-Assessment 7

Question 1

The common law principles will apply to the recognition of foreign judgments by a South African court, except that of Namibia. The foreign judgment not directly enforceable in South Africa but establishes a course of action that will be enforced by South African courts if the following common law requirements are met:

- the foreign court must have had international competence as determined by South African law;
- the judgment must be final and conclusive;
- the enforcement of the judgment must not be contrary to South African public policy or the concept of natural justice;
- the judgment must not have been obtained fraudulently;
- the judgment must not involve the enforcement of a penal or revenue law of the foreign state; and
- enforcement must not be prohibited by the Protection of Businesses Act 99 of 1978.

A South African court will also take into account the principles of comity that exists between the states and whether it is just and equitable to recognise a judgment.

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