Elements of Bankruptcy law and Business Rescue in South Africa

1. Introduction

The South African legal system stems from Roman Dutch law, which is generally referred to as our common law. English law did however influence our law, in particular areas of mercantile law, like the law of insolvency and company law. We also adopted the English system of precedents. Although our law is not codified, legislation, our 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 our law.1 The new political dispensation has, however, changed the face of our law dramatically in that the Constitution of the Republic of South Africa now contains a bill of rights. In view of this development our courts may test legislation in order to establish the constitutionality thereof - the Constitution being the supreme law of the land.2

When turning to the law of insolvency it is interesting to note that the Insolvency Ordinance of Amsterdam of 1777 is cited as the foundation of our insolvency law.3 Our first insolvency legislation was, however, introduced in 1829 in the former Cape Colony and it was based on English bankruptcy law.4 Ordinance 6 of 1843 (Cape) which abolished the concept of cessio bonorum5 replaced the 1829 Ordinance and it also formed the statutory basis for Insolvency Ordinances of the former pre-union republics i.e. Transvaal, Orange Free State and Natal. In 1916, and after the establishment of the South African Union in 1910, the Insolvency Act of 1916 was adopted as the first uniform insolvency law for the whole of South Africa. Currently the law relating to insolvent persons is in principle regulated by Insolvency Act 24 of 19366 which act came into force on 1 July 1936 but the Act is incomplete as discussed below.

2. Main sources

South African insolvency law is not contained in one single act although it is largely regulated by the Insolvency Act 24 of 1936 which Act deals with the sequestration of individuals and related matters. Regarding corporate bankruptcy, the former Companies Act 61 of 1973 and the Close Corporations Act 69 of 1984 contain

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4 JW Wessels History of the Roman Dutch Law (African Book Co, Grahamstown, 1908) p 670. This Ordinance retained some of the Dutch practices, like cessio bonorum i.e. a surrendering by the debtor of his estate to his creditors.
5 See previous fn.
chapters that dealt with the winding-up (or liquidation) of companies and close corporations respectively. These provisions were however not complete and in relation to insolvent companies or close corporations, certain sections of these Acts made certain provisions of the Insolvency Act 24 of 1936 as well as South African common law provisions applicable to the liquidation or winding-up of companies or close corporations that were unable to pay their debts. The 1973 Companies Act was however replaced by the Companies Act 71 of 2008 as from 1 May 2011. The 2008 Act brought about certain amendments regarding the winding up and liquidation of companies and close corporations as will be discussed below. Suffice to say at this point that the 2008 Companies Act does not provide comprehensively for the winding-up of companies and that it has set a process in motion to phase out the close corporations as a business form. A new business rescue procedure has however been introduced by the 2008 Companies Act that has replaced judicial management of the 1973 Companies Act as a formal rescue procedure.

There are also special provisions applicable to the winding-up of other legal entities such as pension funds, banks, medical funds, insurance companies and co-operatives in various other pieces of legislation as indicated in the footnote. In the last mentioned instances there are usually certain sections in the Acts listed in footnote 7 that deals with the winding-up or administration of such institutions whilst they are debt stressed – some of these provisions also refer back to provision in other legislation dealing with liquidations, like the Companies Act.

Apart from these statutory enactments, precedents and our common law principles will also apply in the absence of specific statutory provisions. The Insolvency Act of 1936, however, remains the principal source of our insolvency law and the other legislation renders certain provisions of the Insolvency Act applicable.

3. Security and enforcement of creditor rights in general

Creditors have both common law rights and statutory measures at their avail to protect and enforce their rights.

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9 This discussion will largely focus on sequestration of debtors in terms of the Insolvency Act and liquidations of companies in terms of the Companies Act. See the discussion infra.
Both secured and unsecured credit arrangements are available. The main forms of real security that can be negotiated when credit is granted are special mortgage bonds over immovable property and special notarial bonds over movable property, and pledges of movable property.\textsuperscript{10}

A so-called general notarial bond covering all the movable assets of a debtor may also be granted but although it offers some preference with regard to the proceeds of such right, the creditor is not deemed to be a secured creditor unless such bond contains a perfection clause that allows the creditor to take possession of the goods in case of default in order to establish real security. Perfection is usually effected by means of a court order.\textsuperscript{11}

South African law also acknowledges real security that can come about by operation of law, ie hypothecs and liens. Some legislation also provide for specific statutory charges that may put a particular creditor almost in the same position as a secured creditor.\textsuperscript{12}

Both mortgage bonds and notarial bonds must be registered in the South African Deeds Registry before they will provide security. The mortgage bond over immovable property is probably the best form of real security that a creditor can obtain.

The notarial bond over movable property has some advantage over a pledge of movables, since in the first instance the debtor may remain in possession of the assets whilst in the case of a pledge the asset must be and remain in the possession of the creditor in order to be effective as a security. It must be noted that the Deeds Registry reflects ownership and other real rights, such as mortgage bonds, in land, ie immovable property, but the system also allows for the registration of notarial bonds over movable property. Once again, registration is required before the security will become effective.

Personal security that will grant a right of personal security is available in the form of suretyship and indemnifications but these offer no real security since suretyship as such does not provide a security object.

Steeped in a strong constitutional dispensation that has the rule of law as an underpinning, South Africa has a fairly strong judiciary system in place and it is fair to say that debt enforcement procedures are in general clear and predictable, both by means of individual action or collective proceedings.

\textsuperscript{10} See the definition of ‘security’ in the Insolvency Act 24 of 1936, s.2.
\textsuperscript{12} See for instance the Alienation of Land Act 68 of 1981, s.20(5).
The courts involved in debt enforcement are usually the High Courts and the Magistrates’ Courts. The rules of these courts make provision for individual enforcement in case of secured and unsecured debt.

Collective debt enforcement proceedings are provided for by the Insolvency Act 24 of 1936 that deals first and foremost with natural person debtors (individuals), partnerships, trusts and voluntary associations but the system is fragmented in that winding-up or liquidation of, for instance, companies and close corporations are also dealt with by the Companies Act 61 of 1973 (the Companies Act of 1973), the Companies Act 71 of 2008 and the Close Corporations Act 69 of 1984 (the Close Corporations Act of 1984) which Acts in turn refer back to the Insolvency Act of 1936 in some instances. In view of section 79(2) read with Item 9 of Schedule 5 and Schedule 3 of the 2008 Companies Act, this system of incorporation seems to be even more complicated than before 1 May 2011.

Outside the insolvency ambit, unsecured creditors can thus enforce their rights by obtaining a court judgment. A default judgment will be available when the debtor does not oppose the application for judgment or consents to judgment. In the event that the debtor fails to comply with a court judgment, the creditor may obtain a writ of execution and have this enforced by a Sheriff via enforcement procedures provided for in relevant legislation and the rules of court.

By the initiation of sequestration or liquidation, the collective enforcement procedure is set into motion. The relevant legislation provides for a proper and predictable procedure to deal with the administration subsequently, providing for payment of both secured and unsecured creditors. It must be noted that the applicability of different pieces of legislation and even the common law – especially in case of company or close corporation liquidation – can be confusing to foreign creditors.

South Africa nevertheless has a clear system for the enforcement of both secured and unsecured credit claims. Though the courts have a heavy workload and there are significant delays in obtaining court hearings in some instances, the court system is generally seen as being competent.

It is important to take cognisance of the National Credit Act 34 of 2005 that applies to certain defined credit agreements and has had a profound effect on many aspects of especially consumer credit since its inception. The National Credit Act of 2005 thus first and foremost applies in case of secured and unsecured credit agreements where consumers are entering into credit agreements regulated by this Act. It only has limited application in case of juristic person debtors. The NCA is regulated by the National Credit Regulator. It has an effect on debt enforcement since creditors

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13See the Supreme Court Act 59 of 1959 and the Uniform Rules of the High Courts.
14See the Magistrates’ Court Act 32 of 1944 and the Rules of the Magistrates’ Courts.
15Burdette, D., “The application of the law of insolvency to the winding-up of insolvent companies and close corporations” 2003 THRIR 591.
16The National Credit Act 34 of 2005 came into full force and effect on 1 June 2007.
17Ibid., ss.4(1)(a) and 6.
18Ibid, s.12.
must first send a so-called section 129 notice to debtors before initiating debt enforcement procedures in relation to credit agreements regulated by this Act.

4. Regulatory framework

It is important to note that the administration of insolvent estates of individuals, as well as other debtors such as companies, takes place under the supervision of the Master of the High Court.19

The Master of the High Court has a number of statutory duties including the supervision of insolvent and deceased estates and cannot be seen as an insolvency regulator in the full sense of the word.

In the case of a debtor as defined in the Act, a trustee is appointed (in the case of a company or close corporation a liquidator is appointed) to take charge of the administration of the respective estates.

Trustees or liquidators are in principle elected at the first meeting of creditors by those creditors who have proved their claims,20 but the ultimate responsibility of appointing an elected trustee rests with the Master. In practice creditors nominate persons who usually take appointments as trustees or liquidators to be appointed as trustee or liquidator even before the first meeting of creditors has taken place (this is the so-called requisition practice), and the Master who has a discretionary statutory authority to appoint a provisional trustee or liquidator may then consider the appointment of such a nominated person as a provisional trustee or liquidator in that particular case.

Although trustees and liquidators need no special licence to act as such under South African law, the Master keeps a list of persons which are eligible for appointment and they usually hail from trust companies, firms of accountants or attorneys.21

At present the appointment of insolvency practitioners is under scrutiny since affirmative action practices to allow more Previously Disadvantaged Individuals (PDI’s) to act as such, plays a role in the appointment of trustees and liquidators and a new policy document is to be introduced in this respect.

In corporate bankruptcy the former Registrar of Companies, later termed the Company and Intellectual Property Office (CIPRO) and now in terms of the 2008 Companies Act, termed the Company and Intellectual Property Commission (CIPC or the Commission) also has certain statutory duties relating to winding-up and rescue proceedings. Section 138 of the 2008 Act has established a system of licensing for rescue practitioners.

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19 The Master of the High Court is a public official whose functions include the supervision of the administration of insolvent estates by appointing trustees or liquidators, giving them directions as to certain aspects of the administration of insolvent estates and confirming the formal estate accounts.

20 See s 54(1) of the Insolvency Act and ss 364(2) read with 369 of the Companies Act.

21 Some believe that the Master’s powers are too wide in this respect. Cf. K. Van Rensburg “The appointment of provisional trustees and liquidators” 1998 De Rebus at p 70.
5. Consumer bankruptcy

In terms of the Insolvency Act 24 of 1936 a debtor that may include a natural person, i.e. an individual or a partnership for instance may be sequestrated voluntarily or compulsorily by means of a High Court order. There are certain statutory requirements like an advantage of creditors that must be proved. This process will result in a liquidation of assets.

Although a debtor may in principle enter into a debt rearrangement agreement with his or her creditors, statutory debt relief measures that will result in such rescheduling of payment are limited. For the individual there is debt review in terms of the National Credit Act but it only applies to credit agreements to which this Act apply, or administration orders in terms of the Magistrates Court’s Act but this relief is limited to debts of not more than R50 000, ie, US $7000.

6. Corporate bankruptcy

6.1 Liquidation

For a comprehensive understanding of winding-up or liquidation law in South Africa it is nevertheless important to note that the new Companies Act 71 of 2008 that applies since 1 May 2011 makes provision for the winding-up or liquidation of solvent companies but that the chapter 14 of the former 1973 Companies Act will continue to apply in case of the initiation of insolvent companies, as well as in relation to the administration process following the initiation of the liquidation process.

An insolvent company (including an external company) registered in terms of the former Companies Act 61 of 1973 can thus still be wound up by the High Court, or voluntarily by means of a special members resolution in terms of this otherwise revoked act.22 Chapter 14 of the 1973 Companies Act thus provide rules for the initiation, commencement and to a large extent for the administration of the company in liquidation, but section 339 provides in general for the incorporation of the insolvency law for those aspects that were not regulated in Chapter 14 as such. Other sections of chapter 14 like section 340 also incorporates provisions of the Insolvency Act 24 of 1936, whilst some sections made it clear that they would only apply to companies being unable to pay their debts.

6.1.1 Gateways

Although section 344 of the 1973 Companies Act provides various statutory grounds to apply to the High Court for a winding-up order, the process will since 1 May 2011 only apply to insolvent companies. It is therefore submitted that the ground in section

22 Section 343 of the Companies Act. Companies that are either commercially or (f)actually insolvent are wound up under the Companies Act 1973 (Firstrand Bank Ltd. v. Lodhi 5 Properties Investment CC, 2013 (3) SA 212 (GNP) par [35]). In the Companies Act 2008 ss 79–81 and item 9 of Sched. 5, the word “solvent” includes commercial solvency, and the word “insolvent” includes commercial insololvency (Standard Bank of South Africa Ltd. v. R-Bay Logistics CC, 2013 (2) SA 295 (KZD) pars [14], [16], [36]).
344(f) that deals with a company that is unable to pay its debts will be the most important one in future to deal with this type of liquidation.

Section 345 also supports the ground in section 344 (f) by providing a presumption in relation to the inability to pay its debt. A company or body corporate shall thus be deemed to be unable to pay its debts if:

(a) a creditor to whom the company is indebted in a sum not less than R100 then due has served on the company a demand requiring the company to pay the sum so due and the company or body corporate has for three weeks thereafter neglected to pay the sum or to provide security to have paid same, or

(b) any process issued on a judgement, decree or order of any court in favour of a creditor of the company is returned by the sheriff or the messenger with an endorsement that there is not sufficient disposable property to satisfy the judgement or that any disposable property found did not upon sale satisfy such process; or

(c) it is otherwise proved to the satisfaction of the Court that the company is unable to pay its debts.  

In the case of a liquidation by Court, the liquidation commences at the date of presentation of the application for liquidation.  

The company may also be voluntarily liquidated. The procedure is effected by a special resolution of members but may be either a winding-up by members or creditors. The voluntary liquidation by members will be in the case where the company is able to pay its debts, while the voluntary liquidation by creditors will be when the company is insolvent. In both instances the process is initiated by a special resolution by members. In the latter case the directors present a prescribed statement of affairs to the meeting and upon registration of the special resolution the liquidation commences and follows the same procedure as in the case of a liquidation by Court.  

The 1973 Companies Act was, however, replaced by the new Companies Act 71 of 2008 as from 1 May 2011 when the 2008 Act came into operation. Sections 79 to 81 of the 2008 Companies Act provide for the initiation of the winding-up of solvent companies – either voluntarily by means of a member’s resolution, or by means of a court order. The 2008 Companies Act does not provide rules to deal with the subsequent liquidation of the wound-up solvent company but provides in section 79(2) read with Item 9(2) of Schedule 5 that the winding-up and liquidation

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23 Section 345 of the Companies Act. The issue here is usually that the company's assets exceed the amount of liabilities (factual solvency), but that it is unable to pay the debts as they fall due. The court has determined that this situation is not a bar to liquidation on account of commercial insolvency: Rosenbach & Co (Pty) Ltd v Singh’s Bazaars (Pty) Ltd 1962 4 SA 593 (D).

24 Section 348 of the Companies Act.

25 Sections 350 and 351 of the Companies Act.

26 Section 351(2) of the Companies Act.
provisions as contained in chapter 14 of the 1973 Companies Act will continue to apply to companies in terms of the 2008 Companies Act, bar certain sections.

With regard to the initiation of winding-up and liquidation of insolvent companies, it must however be noted that chapter 14 of the 1973 Act will in principle still regulate aspects of the winding-up and liquidation of companies until new insolvency legislation has been enacted.27

Section 79(3) of the 2008 Companies Act allows for an application to court for an order to convert the voluntary winding-up in terms of the 2008 Act to an insolvency winding-up in which case chapter 14 of the 1973 Companies Act will apply.

6.1.2 Directors’ liability: fraudulent, reckless insolvent trading etc

It is to be noted that the fraudulent and reckless trading provision dealing with personal liability of directors and officers contained in section 424 of the repealed 1973 Companies Act will still find application – where relevant – since Chapter 14 of the 1973 Companies Act still applies.28 In terms of section 424 of the 1973 Companies and 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.29

Section 22(1) of the 2008 Companies Act prohibits a company from carrying on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose. The Commission may, if it has reasonable grounds to believe that a company is engaging in such prohibited conduct, or is unable to pay its debts as they become due and payable in the normal course of business, issue a notice to show cause why the company should be permitted to continue with its business, or trade as the case may be.30 The sanction in section 22(3) for a company who fails to satisfy the Commission within 20 business days that it is not transgressing section 22(1), or that it is able to pay its debts, as they become due and payable in the normal course of business is that it will then receive a compliance notice from the Commission requiring the company to cease carrying on business or trading as the case may be.

It must in general be noted that section 76 of the 2008 Companies Act sets standards of directors’ conduct. Section 77 deals directly with the liability of directors and prescribed officers for any loss, damages or costs against the company where in accordance with the common law principles relating to non-compliance with fiduciary duties, or a breach of duty contemplated in sections 75, 76(2) or 76(3)(a) or (b), or common law principles relating to delict (tort). In particular it must also be noted that a director will become liable where he or she acquiesced in the carrying on of the

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27 Item 9 Schedule 5 of the Companies Act of 2008.
28 Section 79(2) read with Item 9 of Schedule 5 of the 2008 Companies Act.
29 See *Ex parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T); *Ex parte Clifford Homes Construction (Pty) Ltd* 1989 (4) SA 610 (W) 612G – 613H; *Ex parte De Villiers NO: In re MSL Publications (Pty) Ltd* 1990 (4) SA 59 (W); *Heneways Freight Services (Pty) Ltd v Grogor* 2007 (2) SA 561 (SCA); *Sainic v Industro-Clean (Pty)Ltd* 2009 (1) SA 538 (SCA); *Fourie NO v Newton* [2011] 2 All SA 265 (SCA).
30 Section 22(2).
business despite knowing that it was being conducted in a manner prohibited by section 22(1) as discussed above. Section 218(2) provides for a general statutory liability of any person towards any other person (for loss suffered) as a result of contravening any provision in this Act. Liability is thus based on a contravention of the Act as envisaged by section 218(2).

6.1.3 Rules of distribution (secured and unsecured creditors as well as priorities) Distribution of Estate

Where secured assets are sold by the trustee or liquidator, the proceeds from the sale are separated and used to satisfy the claims of the secured creditors (less the administrative costs of sale etc). Any surplus funds are retained by the insolvent estate, along with all funds derived from the realization of the unsecured assets of the debtor – these amounts form the free residue.

Following the realization of the assets of the debtor, the liquidator must prepare a liquidation account, detailing all receipts and payments and a plan for the distribution of the estate. Such a liquidation account must be made within six months of the appointment of the liquidator, unless an extension of time is granted by the Master of the High Court.

Following the confirmation of the liquidation account, and the payment of the funeral expenses of the debtor (in case of an individual and where applicable), any remaining monies are distributed in the following order:

- Costs of the liquidation;
- Costs of executions against the insolvent estate;
- Employee entitlements;
- Certain statutory obligations;
- Government tax claims;
- Preferences under a general mortgage bond; and
- Ordinary (concurrent) creditors.

[Shareholders will in principle only be entitled to payment for their shares once the creditors have been paid, which is rare in an insolvent situation.]

Where the assets of the debtor are insufficient, the funds will be distributed pari passu amongst the creditors, in order of priority. If the assets of the debtor are sufficient to

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31Insolvency Act 24 of 1936, ss.88 and 95.
32Stander, L., “Secured claims in insolvency and the order of preference among creditors secured by the same property” 2000 TSAR 542.
33Insolvency Act 24 of 1936, ss.91 and 109; Companies Act 61 of 1973, ss.403 and 404.
34Companies Act 61 of 1973, s.408.
35Insolvency Act 24 of 1936, s.97.
36Ibid., s.98.
37Insolvency Act 24 of 1936, s.98A as inserted by the Judicial Matters Second Amendment Act 122 of 1998, s.2.
38Ibid., s.99.
39Insolvency Act 24 of 1936, s.101.
40Ibid., s.102.
41Companies Act 61 of 1973, s.342(1).
cover all creditor claims, then the remaining free residue is applied to the payment of unsecured claims on a pro rata basis. 42

Where there is a shortfall to pay the costs of liquidation, the insolvency law prescribes a system whereby creditors must make contributions in order to meet this shortfall. 43

6.1.4 Treatment of avoidable dispositions and executory contracts

6.1.4.1 Voidable dispositions and related remedies

The trustee may take legal action to set aside any improper disposition of property made by the insolvent before the sequestration of his estate. The trustee may rely on an action of the common law, the actio Pauliana, if any alienation defrauded (prejudiced) the creditors, 44 or he may rely on the provisions of the Act. 45 If the trustee fails to institute an action, any creditor may do so in the name of the trustee and upon indemnifying the trustee against all costs. 46

All the transactions/dispositions referred to in the Insolvency Act deal with "dispositions" of rights to property as defined in section 2 of the Act. 47 The Insolvency Act provides for the following categories of voidable dispositions par excellence: Dispositions without value, voidable preferences, undue preferences and collusion. 48

The 2000 Draft Insolvency Bill (in Working Document format) proposed the introduction of special rules for dispositions made to 'associates', the introduction of time limits in case of dispositions without value and undue preferences, as well as a new definition of the term 'disposition'. 49 Commentary was invited on the question of the introduction of a presumption of insolvency for the purposes of voidable dispositions. 50 (These aspects were addressed in the 2010 version.)

6.1.4.2 Unexecuted contracts

42 Ibid., s.103.
43 Ibid., s.106.
44 Sources of seventeenth century writers on Roman Dutch law like Voet Commentarius ad Pandectas ad D 42 8 and Pothier Commentarius ad Pandectas ad D 42 8 are still authoritative in this regard. See A. Boraine "Towards Codifying the Actio Pauliana" (1996) SA Mercantile Law Journal 213 where the author also argues for the codification of this action in a new Insolvency Act since it forms the backbone of fraudulent conveyance law in our law.
45 Sections 26-33 of the Insolvency Act.
46 Section 32(1) of the Insolvency Act.
47 The definition of 'disposition' is very wide and includes any transfer or abandonment of rights to property, see s 1 of the Insolvency Act.
48 Sections 26-31 of the Act. The Act also embodies related remedies like the s 34 that voids the transfer of a business in certain circumstances and the disregarding of pre-sequestration set-off i.t.o. s 46 of the Insolvency Act.
49 Clauses 18(1) and 20(1) read with the definitions of 'associate' and 'disposition' in cl 1 of the Draft Insolvency Bill.
50 Explanatory Memorandum at 81-82.
Obligations of parties to a contract are generally not automatically terminated by the sequestration of one of the parties. The interests of the general body of creditors take precedence over the interests of the individual creditor due to the *concurrus creditorum*. A trustee may thus elect to perform in terms of the contract, but he should act in the best interests of the creditors. A trustee's decision not to perform constitutes breach of contract, namely repudiation.\(^{51}\) The solvent party will usually accept the repudiation by cancelling the contract whereafter he will then be entitled to recover property in which he retained ownership. In respect of payments made by him, and damages suffered as a result thereof, he merely has an unliquidated concurrent claim.\(^{52}\)

These principles derived from our common law should, however, be applied in view of any statutory provision, which deals with a particular type of contract. For example the sequestration of the estate of an employer now suspends contracts of service between him and his employees.\(^{53}\) Such contracts may either be transferred in terms of section 197A of the Labour Relations Act to a new owner of the business or they will be finally terminated as provided for by section 38 of the Insolvency Act. [The latter are entitled to claim compensation from the insolvent estate for any loss suffered in the event of termination. Although employees are entitled to unemployment insurance fund payments during the period of suspension of their contracts of employment, South African law does not provide for a fund that would compensate employees for salary in arrears et cetera in the case of insolvency of the employer. Instead employees have, for instance, preferential claims (priorities) of up to a maximum of 12 thousand rand for salary or wages not exceeding three months' salary or wages due and owing before the date of sequestration.\(^{54}\) Claims, which exceed these limits, are of a concurrent nature. If the business or undertaking of such an insolvent employer is transferred to a new owner as a going concern, the contracts of service are automatically transferred in terms of section 197A of our new Labour Relations Act 66 of 1995.\(^{55}\)]

### 6.1.5 Position of employees

Fair labour practices is a basic right in South African law and this aspect has had a profound effect, also within the field of insolvency law. The position in relation to employment contracts in liquidation are discussed in C10. As indicated above, pre-liquidation claims by employees for salaries, wages and bonuses in arrear are treated as statutory preferential (priority) claims up to a prescribed limit; any balance would

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\(^{52}\) Clause 62(4)(e) and (11) of The Draft Insolvency Bill proposes the codification of the general principle.

\(^{53}\) Section 38 of the Insolvency Act. Labour law reform influenced South African insolvency law a great deal since the new political dispensations, see S. Van Eck and A. Boraine 'The Insolvency and Labour Package: How successful was the integration' (2003) 24 *ILJ* 1840 in this regard. Regarding various other statutory arrangements in respect of unexecuted contracts, see s 35 pertaining to contracts of sale of immovable property when the purchaser is sequestrated; s 36 dealing with cash sales of movable property when the purchaser is sequestrated; s 37 i.r.o. contracts of lease; and s 84 dealing with the sequestration of purchasers in terms of credit sales transactions in terms of the Credit Agreements Act 75 of 1980.

\(^{54}\) Section 98A of the Insolvency Act.

\(^{55}\) The rights and obligations between the insolvent employer and his employees will, however, still be dealt with in terms of ss 38 and 98A of the Insolvency Act.
then be an unsecured concurrent claim. South Africa does not have a wage guarantee fund in this respect. (Where the business is for instance not continued after commencement of liquidation, those employees who qualify may have a claim for unemployment benefits against the unemployment fund.)

The new business rescue procedure in the 2008 Companies Act as discussed below provides a super-preference for employees regarding their salary claims after commencement of the rescue procedure that will be carried over to the liquidation forum if a company in rescue is subsequently liquidated.

6.2 Rescue

6.2.1 Procedures

6.2.2.1 Formal

Chapter 6 of this Act contains a new business rescue provision for companies that have replaced judicial management of the 1973 Companies Act when the 2008 Act came into force on 1 May 2011. It is hailed as an improvement on judicial management since it is said to be more flexible. It will apply to both companies and close corporations.56

(a) Eligibility

The rescue procedure can be initiated by means of a resolution of the board of directors or by court order applied for by an affected person, or during court proceedings to apply for liquidation, or the enforcement of security rights. If the company is already under liquidation, only a court order may initiate rescue proceedings.57

Any affected person, that is, a shareholder, creditor, trade union representing employees or an unrepresented employee in terms of section 128(1)(a) may apply to court to place a company under supervision and commence business rescue proceedings.58 The rescue will in such an instance in terms of section 132(1)(b) commence when the application is issued.

(b) Requirements

When deciding to initiate the rescue procedure, the board must have reasonable grounds to believe that the company is financially distressed as defined in terms of section 128(1)(f) of the Act and that there is a reasonable prospect of rescuing the

56 See Item 6 Schedule 3 of the 2008 Companies Act.
57 Section 129 and 131 of the 2008 Companies Act.
58 Section 131(1).
company.\(^{59}\) In such an instance rescue proceedings will commence when the resolution is filed with the Commission.\(^{60}\)

Section 128(1)(e) provides that a High Court will have jurisdiction over business rescue proceedings of companies but in addition to making a business rescue order, the court can be involved only in a number of instances expressly mentioned in the Act, such as objections against business rescue resolutions adopted by the board of a company. It allows the creation of a specialist commercial court through the designation of particular judges to specialise in commercial matters, commercial insolvencies and business rescue.

\(\text{(c) Summary of the process}\)
In general section 132(1) states that the rescue commences in case of voluntary rescue when the company files a resolution to place itself under supervision in terms of section 129(3); or in case of application, when application is made to the court for an order placing the company under supervision in terms of section 131(1); or when a court makes an order placing a company under supervision during the course of liquidation proceedings, or proceedings to enforce a security interest, as contemplated in section 131(7). A general moratorium regarding pre-rescue debt enforcement sets in as from commencement and a rescue practitioner is appointed. The main task of the rescue practitioner is to consider the future prospects of the company and, if any, to prepare a rescue plan with the view of being adopted by the relevant affected parties. If accepted by means of a vote, the rescue practitioner must execute the plan and if successful, the rescue procedure will cease. When there is no reasonable prospect of the company being rescued, the rescue may be converted to liquidation.\(^{61}\)

The chapter 6 rescue procedure in this Act is hailed as an improvement on judicial management since it is said to be more flexible. Its salient features are the following:
- It can be initiated by means of a resolution of the board of directors or by court order, or during court proceedings to apply for liquidation or the enforcement of security rights. If the company is already under liquidation, only a court order may initiate rescue proceedings;\(^{62}\)

\(^{59}\) Section 128(1)(h) read together with section 128(1)(b) of the Act. This means that there is a reasonable prospect that the company will be able to continue in existence on a solvent basis or, if that is not possible, that creditors or shareholders will receive a better return compared to its immediate liquidation. The first is the primary goal and the second, the alternative (see Oakdene Square Properties (Pty), Ltd. v. Farm Bothasfontein (Kyalami) (Pty), Ltd., [2013] ZASCA 68 (27 May 2013) par [23]. “Better return” means that there is more money overall to be distributed to creditors, with the result that they would receive a greater distribution than would be the case in a liquidation” (See Commissioner, South African Revenue Service v. Beginsel NO, 2013 (1) SA 307 (WCC) par [58]).

\(^{60}\) Sections 129(2)(b) and 131(1)(a)(i).

\(^{61}\) See section 81(1)(a) and (b) and section 132(2)(b) or (c).

\(^{62}\) Ibid., s.129.
• When deciding to initiate the rescue procedure, the board must have reasonable grounds to believe that the company is financially distressed\(^{63}\) and that there is a reasonable prospect of rescuing the company;\(^{64}\)

• Section 128 provides that a High Court will have jurisdiction over business rescue proceedings of companies but in addition to making a business rescue order, the court can be involved only in a number of instances expressly mentioned in the Act, such as objections against business rescue resolutions adopted by the board of a company. It allows the creation of a specialist commercial court through the designation of particular judges to specialize in commercial matters, commercial insolvencies and business rescue;

• Any affected person, ie a shareholder, creditor, trade union representing employees or an unrepresented employee may apply to court to place a company under supervision and commence business rescue proceedings;\(^{65}\)

• A qualified business rescue practitioner must be appointed;\(^{66}\)

• In principle the directors may remain, ie a debtor in possession situation, but the rescue practitioner is in control of the company and may apply to court to remove a director;

• The rescue practitioner may also remove any person from office or appoint a person as part of the management of the company;\(^{67}\)

• Affected parties, ie shareholders, creditors and employees (or their trade unions) may give input and the Act allows the creation of creditor and employee committees if these parties so elect;\(^{68}\)

• The rescue practitioner will have statutory powers, for instance to partially or completely reject (only with court approval after amendments to the Act) or suspend contracts – except contracts of employment which may only be amended or suspended in line with labour law legislation;\(^{69}\)

• The rescue practitioner must also investigate all the financial affairs of the company and steps may follow, such as avoidance of transactions and the removal of directors;\(^{70}\)

• The main task of the rescue practitioner is to develop a rescue plan in consultation with creditors, employees, shareholders and management and to get the required approval for its implementation;\(^{71}\)

• A plan must be published within 25 business days after the practitioner’s appointment, unless the court or the majority of the creditors allows longer time in terms of section 150(5);

\(^{63}\) A company is regarded as financially distressed if it appears reasonably unlikely that the company will be able to pay all of its debts as they fall due and payable within the immediately ensuing six months or if it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months – see Companies Act 71 of 2008, s. 128(1)(f) and see fn 59.

\(^{64}\) A reasonable prospect of “rescuing the company” means a reasonable prospect that the company will be able to continue in existence on a solvent basis or, if that is not possible, that creditors or shareholders will receive a better return compared to immediate liquidation of the company – see Companies Act 71 of 2008, s.128 (1)(b) read together with s.128(1)(b) and see fn 59.

\(^{65}\) Ibid., s.131(1).

\(^{66}\) Ibid., s.138.

\(^{67}\) Ibid., s.140(1)(c)(i) and (ii).

\(^{68}\) Ibid., ss.144 and 145.

\(^{69}\) Ibid., s.136. Note that this section is currently subject to amendment in order to provide for court approval of cancellation.

\(^{70}\) Ibid., ss.140(c)(i) and 141(2)(c)(ii).

\(^{71}\) Ibid., ss.150 and 152.
• A meeting to consider the future of the company must be held within ten business days after the publication of the plan and with at least five business days’ notice to affected persons, and within ten business days of publication of the plan; \(^\text{72}\)

• The plan must then be adopted by means of a vote and voting interests are determined by the value of a creditor’s claim (including the full value of a secured claim) as provided for in section 145(4);

• If the plan is rejected the practitioner or an affected person may apply to court to set aside the result of the vote as “inappropriate”; \(^\text{73}\)

• When a business rescue plan has been approved and implemented, section 154(2) prescribes that a creditor is only entitled to enforce a debt owed by the company prior to commencement of the business rescue in terms of such plan;

• When the plan has been substantially implemented the rescue practitioner must file a notice of such implementation in terms of section 152(8). (The Act works on the assumption that the rescue proceeding should as a general rule not last longer than three months, failing which an extension can be applied for to the court, or the practitioner must submit monthly reports to the Commission and all affected.

The chapter 6 rescue procedure in this Act is hailed as an improvement on judicial management since it is said to be more flexible. Its salient features are the following:

• It can be initiated by means of a resolution of the board of directors or by court order, or during court proceedings to apply for liquidation or the enforcement of security rights. If the company is already under liquidation, only a court order may initiate rescue proceedings; \(^\text{74}\)

• When deciding to initiate the rescue procedure, the board must have reasonable grounds to believe that the company is financially distressed \(^\text{75}\) and that there is a reasonable prospect of rescuing the company; \(^\text{76}\)

• Section 128 provides that a High Court will have jurisdiction over business rescue proceedings of companies but in addition to making a business rescue order, the court can be involved only in a number of instances expressly mentioned in the Act, such as objections against business rescue resolutions adopted by the board of a company. It allows the creation of a specialist commercial court through the designation of particular judges to specialize in commercial matters, commercial insolvencies and business rescue;

• Any affected person, ie a shareholder, creditor, trade union representing employees or an unrepresented employee may apply to court to place a company under supervision and commence business rescue proceedings; \(^\text{77}\)

• A qualified business rescue practitioner must be appointed; \(^\text{78}\)

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\(^{72}\)Ibid., s.150(1) and (2).

\(^{73}\)Ibid., s.153(1)(b)(ii).

\(^{74}\)Ibid., s.129.

\(^{75}\)A company is regarded as financially distressed if it appears reasonably unlikely that the company will be able to pay all of its debts as they fall due and payable within the immediately ensuing six months or if it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months – see Companies Act 71 of 2008, s. 128(1)(f).

\(^{76}\)A reasonable prospect of “rescuing the company” means a reasonable prospect that the company will be able to continue in existence on a solvent basis or, if that is not possible, that creditors or shareholders will receive a better return compared to immediate liquidation of the company – see Companies Act 71 of 2008, s.128(1)(h) read together with s.128(1)(b).

\(^{77}\)Ibid., s.131(1).

\(^{78}\)Ibid., s.138.
• In principle the directors may remain, i.e., a debtor in possession situation, but the rescue practitioner is in control of the company and may apply to court to remove a director;

• The rescue practitioner may also remove any person from office or appoint a person as part of the management of the company;\(^79\)

• Affected parties, i.e., shareholders, creditors and employees (or their trade unions) may give input and the Act allows the creation of creditor and employee committees if these parties so elect;\(^80\)

• The rescue practitioner will have statutory powers, for instance to partially or completely reject (only with court approval after amendments to the Act) or suspend contracts—except contracts of employment which may only be amended or suspended in line with labour law legislation;\(^81\)

• The rescue practitioner must also investigate all the financial affairs of the company and steps may follow, such as avoidance of transactions and the removal of directors;\(^82\)

• The main task of the rescue practitioner is to develop a rescue plan in consultation with creditors, employees, shareholders and management and to get the required approval for its implementation;\(^83\)

• A plan must be published within 25 business days after the practitioner’s appointment, unless the court or the majority of the creditors allows longer time in terms of section 150(5);

• A meeting to consider the future of the company must be held within ten business days after the publication of the plan and with at least five business days’ notice to affected persons, and within ten business days of publication of the plan;\(^84\)

• The plan must then be adopted by means of a vote and voting interests are determined by the value of a creditor’s claim (including the full value of a secured claim) as provided for in section 145(4);

• If the plan is rejected the practitioner or an affected person may apply to court to set aside the result of the vote as “inappropriate”;\(^85\)

• When a business rescue plan has been approved and implemented, section 154(2) prescribes that a creditor is only entitled to enforce a debt owed by the company prior to commencement of the business rescue in terms of such plan;

• When the plan has been substantially implemented the rescue practitioner must file a notice of such implementation in terms of section 152(8). (The Act works on the assumption that the rescue proceeding should as a general rule not last longer than three months, failing which an extension can be applied for to the court, or the practitioner must submit monthly reports to the Commission and all affected.

(d) Position of directors (debtor in possession and personal liability if any)

\(^79\)Ibid., s.140(1)(c)(i) and (ii).

\(^80\)Ibid., ss.144 and 145.

\(^81\)Ibid., s.136. Note that this section is currently subject to amendment in order to provide for court approval of cancellation.

\(^82\)Ibid., ss.140(c)(i) and 141(2)(c)(ii).

\(^83\)Ibid., ss.150 and 152.

\(^84\)Ibid., s.150(1) and (2).

\(^85\)Ibid., s.153(1)(b)(ii).
The directors have to co-operate with and assist the practitioner. In this regard they have specific duties to deliver to the practitioner books and records in their possession that relate to the company’s affairs, to inform the practitioner of the whereabouts of other books and records, and to provide the practitioner with a statement of affairs within five business days after the commencement of business rescue proceedings or within such extended time allowed by the practitioner as provided by section 142(1) to (3). The minimum content of the statement of affairs is prescribed in section 142(3). Directors have to attend to the requests of the practitioner and provide the practitioner with any information on the company’s affairs reasonably required by the practitioner.

Directors must continue to exercise their functions as directors, but subject to the authority of the practitioner who has “full management control of the company in substitution for its board and management”. A director must exercise any management function in accordance with the express instructions or direction of the practitioner, but only to the extent that it is reasonable to do so. Where the practitioner is required to approve specific conduct by the board or a director and the board or director purports to act without such approval, the action is void in terms of section 137(4).

A director is relieved from the duties of a director set out in section 76 and from most liabilities under section 77, provided he or she acts under the authority and according to the instructions or direction of the practitioner. A director remains bound by the duty to disclose personal financial interests as required by section 75. The liabilities for which a director remains liable under section 77 in respect of conduct after the commencement of business rescue proceedings are in respect of loss sustained by the company as a result of (i) acting on behalf of the company despite knowing that he lacks authority; (ii) 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 or that it is trading in insolvent circumstances; (iii) 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. (Exposure to liability in respect of trading in insolvent circumstances might be particularly acute during business rescue and section 22(1) should preferably have contained an appropriate exception in respect of business rescue but the 2008 Act is currently undergoing amendments and this provision may still be amended before the Act comes into operation).

Directors must continue to exercise their functions as directors, but subject to the authority of the practitioner who has “full management control of the company in substitution for its board and management”. A director must exercise any management function in accordance with the express instructions or direction of the

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86 Ibid., s.137(2)(a) read with s.140(1)(a).
87 Ibid., s.137(2)(b).
88 Ibid., s.137(2)(d).
89 Ibid., ss.77(3)(a)-77(3)(b) read with ss.22(1) and 77(3)(c).
90 Ibid., s.137(2)(a) read with s.140(1)(a).
practitioner, but only to the extent that it is reasonable to do so. The business rescue practitioner may apply to court for the removal of a director on the basis that the director has failed to comply with a requirement of Chapter 6, or that the director through an act or omission has impeded or is impeding the practitioner’s exercise of his functions or powers, his management of the company or the development and implementation of a business rescue plan as provided in section 137(5).

The practitioner can also appoint persons to the management of the company, either in addition to or in substitution for the current management in terms of section 140(1)(c).

When a company trades under insolvent circumstances as currently mentioned in section 22(1)(b) or carries on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose as meant in section 22(1)(a), the directors who acquiesced in this type of trading will be liable to the company for any loss, damage or costs sustained by the company in terms of section 77(3)(b) to (c). Liability directly towards creditors will be more difficult to establish, as it will have to be based on a contravention of the Act as envisaged by section 218(2). While it is a statutory offence to be involved in a company’s fraudulent trading as per section 214(1)(b) to (c), this is not the case with reckless and insolvent trading. Possibly a director can be said to have contravened the prohibition in section 22(1) (aimed at the company) as an accessory to crime, opening the possibility of personal civil liability in terms of section 218(2). However, this seems like a rather cumbersome procedure compared to section 424 of the 1973 Companies Act which granted creditors a direct right against directors, also during judicial management. The business rescue practitioner nevertheless has to report on reckless or fraudulent trading.

(e) Positions of rescue practitioner: qualifications, appointment, powers and responsibilities.

A qualified and licenced business rescue practitioner as provided for in section 138 of the Act must be appointed. In principle the directors may remain, that is, a debtor in possession situation, but the rescue practitioner is in control of the company and may apply to court to remove a director. The rescue practitioner may also remove any person from office or appoint a person as part of the management of the company.

The rescue practitioner must within ten days of his or her appointment convene meetings with affected parties, that is, shareholders, creditors and employees (or their trade unions) who may give some input in the process. The Act allows for the creation of creditor and employee committees if these parties so elect.

The rescue practitioner will have statutory powers, for instance to partially or completely suspend, or with court approval cancel contracts – except contracts of employment which may only be amended or suspended in line with labour law legislation, or an agreement to which sections 35A or 35B of the Insolvency Act would have applied had the company been liquidated. The rescue practitioner must also investigate all the financial affairs of the company and steps may follow, such as

91 Ibid., s.137(2)(b).
92 Section 140(1)(c)(i) and (ii) of the Act.
93 Sections 144 and 145.
94 Section 136.
avoidance of transactions and the removal of directors. The main task of the rescue practitioner is to develop a rescue plan in consultation with creditors, employees, shareholders and management and to obtain the required approval for its implementation.

(f) Requirements for the plan if any and acceptance (voting)

A plan must comply with the details as prescribed by the Act and be published within 25 business days after the practitioner’s appointment, unless the court or the majority of the creditors allows longer time in terms of section 150(5).

A meeting to consider the future of the company must be held within ten business days after the publication of the plan and with at least five business days’ notice to affected persons. The business rescue plan must then be adopted by means of a vote and voting interests are determined by the value of a creditor’s claim (including the full value of a secured claim) as provided for in section 145(4). If the plan is rejected the Act prescribes some remedies like for instance that the practitioner or an affected person may apply to court to set aside the result of the vote as “inappropriate”.

(g) Moratorium

Section 133 introduces an automatic general moratorium of pre-rescue debt and although the Act does not provide for a compulsory statutory discharge in case of business rescue, the creditors may consent to a discharge of their debt in terms of section 154(1).

(h) Treatment of creditors and their claims

The business rescue plan must set out all known claims against the company and indicate the ranking they would have in insolvency. The property available to satisfy creditors and the order in which claims will rank must be also be set out in the plan.

Pre-rescue creditors may prove their claims to the satisfaction of the rescue practitioner but the enforcement for their claims are in principle subject to the moratorium. When a business rescue plan has been approved and implemented, section 154(2) prescribes that a creditor is only entitled to enforce a debt owed by the company prior to commencement of the business rescue in terms of such plan.

In relation to post-commencement finance and claims section 135 of the 2008 Companies Act provides a super-preference regarding the payment of the rescue practitioner’s remuneration, and wage and related claims by employees. Although post-commencement finance, that is also termed fresh capital, will usually first have to be paid before other claims, these claims by the rescue practitioner and employees will thus enjoy a super preference.

95 Sections 140(c)(i) and 141(2)(c)(ii).
96 Sections 150 and 152.
97 Sections 150(1) and (2).
98 Section 153(1)(b)(ii).
(i) Position of shareholders/members

Transfers of securities in the ordinary course of business may continue. The plan must set out how securities holders will be affected. Unfortunately the Act does not distinguish between shareholders and holders of debt instruments, creating some uncertainty about the correct position of the latter as they are also not excluded from being regarded as creditors.

If the business rescue plan alters the rights of any class of securities holders, the plan has to be approved also by that class of securities holders. Shareholders do not need to approve a plan if it will not alter their rights.

In a company where pre-emptive rights are applicable in respect of the issuing of further shares, such pre-emptive rights will not apply to new shares issued in terms of a business rescue plan, except if the plan preserves those pre-emptive rights as per section 152(7)). The business rescue practitioner may determine the consideration for the new shares and issue them.99

In terms of the new business rescue provision as provided for in the Companies Act of 2008, shareholders will only vote where the plan impacts on their rights.

(j) Treatment of employees

Employees continue to be employed on the same terms and conditions as immediately before the commencement of business rescue proceedings in terms of section 136(1)(a). This is despite any contrary agreement. Changes in the ordinary course of attrition are allowed. The employees and the company may agree on changes to terms and conditions, in accordance with labour laws. Any retrenchments contemplated in a business rescue plan are subject to sections 189 and 189A of the LRA and other applicable labour legislation.100

The new business rescue procedure in the 2008 Companies Act as discussed below provides a super-preference for employees regarding their salary claims after commencement of the rescue procedure that will be carried over to the liquidation forum if a company in rescue is subsequently liquidated. (The new rescue provision also provides extensive protection to the employees with regard to their contracts of employment and they are also acknowledged as a special class of stakeholder/interested party who may form an employees’ committee in rescue.101)

(k) Treatment of avoidable dispositions and executory contracts

Scant provision, if not ineffective, provision is made for the treatment of pre-rescue avoidable dispositions but section 136 makes provision for the rescue practitioner to deal with pre-commencement contracts.

99Ibid., s.152(6).
100Ibid., s.136(1)(b).
101Ibid., ss.135, 136 and 144.
The practitioner is given the power to suspend, entirely, partially or conditionally, any obligation of an agreement to which the company was a party at the commencement of business rescue in terms of section 136(2). This power applies despite any provision of an agreement to the contrary. The other party to the agreement may assert a claim against the company for damages only in terms of section 136(3). Contracts, other than employment contracts and contracts providing for settlement on financial markets etc as provide for in sections 35A and 35B of the Insolvency Act of 1936 may also be cancelled by a court order on the application of the business rescue practitioner. (Initially the power to cancel was also vested in the practitioner but in terms of the 2010 Companies Amendment Bill, the right to cancel will after amendment vest in the court. In terms of the amended section 136(1), the practitioner may suspend any obligation whilst the court may cancel any agreement to which the company is a party.) With regard to a lease contract, where the company is obviously the lessee, it is submitted that the practitioner may decide to suspend the contract that deals with the payment of rent which whilst finalizing the rescue plan. If the practitioner is of the opinion that the contract of lease is actually detrimental to the rescue of the company he or she could then possibly apply for the court’s consent to cancel such a lease.

The other party to an agreement that has been suspended entirely or partially may assert a claim against the company for damages in terms of section 136(3).

The business rescue plan must state how contracts will be treated. The power of the business rescue practitioner to suspend contractual provisions during business rescue and to approach the court for cancellation of contracts has been discussed above. In brief it entails that the practitioner is given the power to suspend, entirely, partially or conditionally, any obligation of an agreement to which the company was a party at the commencement of business rescue in terms of section 136(2) – except a contract of employment. This power applies despite any agreement to the contrary. The other party to the agreement may assert a claim against the company for damages only in terms of section 136(3). Contracts, other than employment contracts and contracts providing for settlement on financial markets etc as provide for in sections 35A and 35B of the Insolvency Act of 1936 may also be cancelled by a court order on the application of the business rescue practitioner. (Initially the power to cancel was also vested in the practitioner but in terms of the 2010 Companies Amendment Bill, the right to cancel will after this amendment will vest in the court.)

(1) Discharge of claims

A business rescue plan must set out the extent to which the company is to be released of the payment of its debts in terms of section 150(2)(b)(ii). However, section 154(1) indicates that a plan may (only) provide for a discharge of a debt if the creditor has “acceded to” this. Such a creditor will lose the right to enforce that debt if the plan is implemented properly. 102 Provided a plan has been approved and implemented, a

102Ibid.,s.154(1). There may be some interpretational difficulty when this is read with the 75% majority cram-down on the minority as provided in s.152(2) read with s.154(2).
creditor is not entitled to enforce a debt owed by the company except as provided for in the plan.\textsuperscript{103} It thus seems that a discharge of debts cannot be forced on non-consenting creditors, because the plan may provide for a discharge only in respect of consenting creditors. The plan as a whole will of course bind all creditors once approved.

(m) Tax implications

Tax liabilities hinder business rescue.\textsuperscript{104} Tax relief may itself be taxable: “tax debt forgiven by [the South African Revenue Service (SARS)] due to a taxpayer’s inability to pay also gives rise to capital gain (i.e. retriggering a portion of the tax just relieved).”

The new tax system governing debts reduced or cancelled from January 1, 2013 deals with debt relief in the form of debt reductions or cancellations for consideration less than full value, and it applies to ordinary revenue and capital gain.\textsuperscript{105} Under the new ordering rules, debt reductions or cancellations within the employment relationship are taxable salary subject to pay-as-you-earn (PAYE) withholding.\textsuperscript{106} Outside this relationship, debt reductions or cancellations, if the debt proceeds are for funding deductible expenditures or allowances, are governed by the ordinary revenue rules. All other debt reductions are dealt with under the capital gain rules.

This new system governs all instances of debt reduction or cancellation for less than full consideration, whether “within insolvency, business rescue, similar statutory proceedings or informal workouts.”\textsuperscript{107} And the system applies even if the reduction or cancellation is not explicitly caused by the inability to pay.

The Advanced Tax Rulings Department (ATRD) may be consulted for a binding ruling on the proposed business rescue plan before it is presented for the majority of creditors to approve.\textsuperscript{108}

Each business rescue will be dealt with on its own merits. It will probably be opposed by SARS if a compromise of tax debt has been applied for in the previous 3 to 5 years. Other considerations include whether the company’s tax returns are up to date, the identity and involvement of the directors in managing the company, and the years for which the debt has been outstanding. The directors’ proper management of the company is an important consideration; improper management may prompt the SARS

\textsuperscript{103}Ibid., s.154(2).
\textsuperscript{104}National Treasury, \textit{Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012} ¶ 2.9.II discussed by Smith and Boraine in Collier International Insolvency Law par 39.05 32 [2][b](vii).
\textsuperscript{105}National Treasury, \textit{Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012} ¶ 2.9.III.A - discussed in Collier International Insolvency Law par 39.05 32 [2][b](vii).
\textsuperscript{106}National Treasury, \textit{Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012} ¶ 2.9.III.B.2 - discussed in Collier International Insolvency Law par 39.05 32 [2][b](vii).
\textsuperscript{107}National Treasury, \textit{Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012} ¶ 2.9.III.B.2. Detailed rules are set out in the remainder of ¶ 2.9 - discussed in Collier International Insolvency Law par 39.05 32 [2][b](vii).
\textsuperscript{108}Tax Administration Act 28 of 2011 ch. 7 on advance rulings - discussed in Collier International Insolvency Law par 39.05 32 [2][b](vii).
to veto the business rescue plan and pursue defaulters for personal liability.¹⁰⁹

(n) Finalisation of process: if successful and if not.

When the plan has been substantially implemented the rescue practitioner must file a notice of such implementation in terms of section 152(8). The Act works on the assumption that the rescue proceeding should as a general rule not last longer than three months, failing which an extension can be applied for to the court, or the practitioner must submit monthly reports to the Commission and all affected persons.¹¹⁰ If the rescue attempt fails, the company should be liquidated.

6.2.2.2 Informal work-outs

Informal corporate workouts are common in the case of large corporate insolvencies, where the bulk of the liabilities are held by a few domestic banks. There is an established, though fairly recent, practice in the banking sector for the main bank holding the largest exposure (“the Lead Bank”) to convene an informal meeting of banks once the seriousness of the financial situation is known, to propose a standstill agreement amongst the banks whereby they agree to maintain their respective levels of exposure and to refrain from taking enforcement action. The Lead Bank will in conjunction with the other banks oversee cash flow and ensure that sufficient pressure is placed on the client to ensure that the banks receive complete financial information. An independent turn around manager is usually also recommended by the banks to assist the client in assessing its financial position and provide recommendations on having the company turned around. The banks will with the client (and turn around manager, where applicable) re-assess the financial and lending position of the client and do a regulated informal work-out or restructuring of banking facilities provided to the client. The main bank will request the debtor company to appoint a nominee from amongst the banks to oversee cash flow, and to ensure that the banks receive complete financial information. The objective of the intervention by the banks is to achieve an optimal outcome for them, which could entail a reduction in exposures and the preservation of the business, or an orderly transition into liquidation. Clearly information of many of these informal workouts are not in the public domain. Although the banks generally work on the eight INSOL principles in conducting the informal corporate workouts, there is, however, not a single set of rules recommended or prescribed by for instance the South African Reserve Bank for use by banks.

6.2.3 Compromises

Unless a company is engaged in business rescue proceedings the board of the company or a liquidator of the company being wound up, may propose an arrangement or compromise of its financial obligations to all of its creditors, or to all of the members or any class of its creditors at a meeting convened with notice to the creditors and the Commission.¹¹¹

¹⁰⁹ See the Value-Added Tax Act 89 of 1991 § 48(9) and Income Tax Act § 97 - discussed in Collier International Insolvency Law par 39.05 32 [2][b](vii).
¹¹⁰ Section 132(2)(c)(ii).
¹¹¹ This procedure will also be available to close corporations see Item 6 Schedule 3 of the 2008 Companies Act.
A proposal is adopted by the creditors of the company, or a class of creditors, if it is supported by a majority in number, representing at least 75% in value of the creditors or class present and voting in person or by proxy, at a meeting called for that purpose.

If a proposal is adopted the company may apply to the court for an order approving the proposal; and the court, may in terms of section 155(7) sanction the compromise as set out in the adopted proposal, if it considers it just and equitable to do so, having regard to:

(a) the number of creditors of any affected class of creditors, who were present or represented at the meeting, and who voted in favour of the proposal;

(b) and in the case of a compromise in respect of a company being wound up, the report of the Master required in terms of the laws contemplated in item 9 of Schedule 5.

A proposal sanctioned by the court is final and binding on all of the company’s creditors or all of members of the relevant class of creditors, as the case may be, as of the date on which the court order is filed with the Commission.112

6.2.4 Treatment of pre-pack arrangements

Although little has been published in relation to pre-packs in South Africa, it is used in practice and it can also be used in relation to an informal work-outs, or with the chapter 6 rescue or compromise procedure as explained above.

6.3 Cross-border insolvency rules

South Africa has no bilateral or multilateral cross-border insolvency treaty with any another jurisdiction. This branch of South African law is presently regulated by the principles of our common law, even though the UNCITRAL Model Law was adopted into our legal system as the Cross-border Insolvency Act 42 of 2000 (see below). Rules of international law, the international lex mercatoria and international comity will, to some extent, play a role in the application of the Act.

At present the common law (or general law) that deals with international private law and precedent in this regard, must still be applied in this area of South African law.113 Based on comity, convenience and equity, a South African High Court is thus still entitled to recognize the appointment of a foreign representative.

112 Section 155(8)(c).
113 Ex parte BZ Stegmann 1902 TS 40; Re Estate Morris 1907 TS 657; Ex Parte Steyn 1979 2 SA 309 (O); Ward v Smit & Others: In re Gurr v Zambia Airways Corporation Ltd 1998 3 SA 175 (SCA).
The principles of private international law (conflict of laws) will also be applied in such an instance, especially with regard to the treatment of property situated in this jurisdiction.

South Africa adopted the so-called UNCITRAL Model Law on Cross-Border Insolvency as the Cross-Border Insolvency Act 42 of 2000 on 8 December 2000. Although this Act came into force on 28 November 2003 by virtue of Proclamation No R 73 of 2003 as published in GG 25768 of 27 November 2003, it is for all practical purposes not in operation yet. This is due to the principle of designation which makes the Act applicable to States to be designated by the Minister of Justice and Constitutional Development. The Act will thus only become effective in respect of designated countries, but no State has been designated as yet.¹¹⁴

Due to the introduction of a system of designation, South African law will in future follow a dual approach to the recognition of foreign bankruptcy orders in that representatives from designated countries will follow the procedure of the Cross-Border Insolvency Act 42 of 2000, whilst those representatives from non-designated countries will still have to follow the general law route that is based on common law and precedent.

However, for the time-being the common law will regulate the recognition of foreign estate representatives by South African courts. (This is an inward bound request for recognition, thus a recognition application to court that may be followed by a recognition order that will serve as a secondary proceeding to the existing foreign bankruptcy order.)

Granting recognition to a foreign administrator to deal with an insolvent’s immovable property in South Africa is a matter for the local court’s discretion. (In practice recognition is also required before a foreign administrator will be allowed to deal with movable assets of a foreign insolvent that is situated in South Africa.) This discretion is absolute but recognition is usually granted in the interests of comity and convenience.

When comparing the two structures, it is clear that foreign representatives and foreign creditors from designated countries, in other words those who will enjoy the benefit of the provisions of the Cross-Border Insolvency Act 42 of 2000, will be in a much better position than those coming from non-designated countries.

### 6.4 Law reform

As far as insolvency law reform in general is concerned, an investigation into the inclusion of corporate insolvency law in a unified Insolvency Act was completed in 2000 by the Centre for Advanced Corporate and Insolvency Law of the University of Pretoria. Although the concept of a unified insolvency legislation was accepted by Cabinet in March 2003, this initiative has stalled for some time but probably due to the new interventions by the Companies Act of 2008 further work has been effected and a working document containing a draft bill titled the Draft Insolvency and

Business Recovery Bill dated 30 June 2010 has been completed by the Department of Justice. It is unclear when this new piece of legislation will be taken forward by government but Item 9 of Schedule 5 of the 2008 Companies Act envisages the introduction of such new legislation. The Companies Act of 2008 has meanwhile introduced a new company rescue procedure that will replace the current system of judicial management as provided for in the Companies Act of 1973 as well as a compromise procedure that can also be used in a rescue realm. As explained above, the 2008 Companies Act brought about certain amendments to the winding-up of both companies and close corporations.