

**RECENT DEVELOPMENTS INSOLVENCY LAWS
SOUTH AFRICA
APRIL 2009**

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RECENT DEVELOPMENTS OF NATIONAL INSOLVENCY LAWS: SOUTH AFRICA APRIL 2009

1. Increase in South African insolvencies

1.1. Insolvencies have increased substantially in South Africa recently.

1.2. According to Statistics South Africa the total liquidation of companies increased by **70% from February 2008 to February 2009**. Insolvencies of individuals (natural persons) have increased by 38.8% from January 2008 to January 2009. Send me an e-mail to mcronje@justice.gov.za if you are interested in the complete statistics.

1.3. Statistics of the Masters of the High Court (the South African insolvency regulator) are probably more accurate but only available to March 2008. The Master's statistics indicate that the total insolvencies (liquidations of companies and insolvency of individuals) was **up 83.7% from the quarter January to March 2007 to the quarter from January to March 2008**.

2. New Companies Act

The President assented to the new Companies Act 71 of 2008 on **9 April 2009**. The Act comes **into operation** on a date fixed by the President by proclamation in the Gazette, which **may not be earlier than one year following the date** on which the President assented to this Act. If you require a copy of the Act send me an e-mail to mcronje@justice.gov.za.

3. Business rescue in terms of the new Companies Act

3.1. Selected definitions in the Act

3.1.1. "Business rescue" means proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for—

(i) the **temporary supervision** of the company, **and** of the **management** of its affairs, business and property;

(ii) a **temporary moratorium** on the rights of claimants against the company or in respect of property in its possession; and

(iii) the development and implementation, if approved, of a plan to **rescue the company by restructuring** its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, **if it is not possible**

for 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.

3.1.2. "Financially distressed", in reference to a particular company at any particular time, means that—

(i) it appears to be 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**

(ii) it appears to be **reasonably likely that the company will become insolvent within the immediately ensuing six months.**

3.1.3. "Affected person", in relation to a company, means—

(i) a **shareholder or creditor** of the company;

(ii) any **registered trade union** representing employees of the company; and

(iii) if **any of the employees of the company are not represented by a registered trade union**, each of those employees or their respective representatives.

3.2. Commencement of business rescue proceedings

3.2.1. The **board of a company may file a resolution** with the Commission (successor to the Registrar of Companies) that the company begin business rescue proceedings and **must appoint a business rescue practitioner who satisfies the requirements of the Act.** This includes being a member in good standing of a profession subject to regulation by a regulatory authority prescribed by the Minister (the regulations or draft regulations have not been made public).

3.2.2. An **affected person may** (after notice to other affected persons) **apply to court for an order-**

(a) **setting aside the resolution**, on the grounds that—

(i) there is no reasonable basis for believing that the company is financially distressed;

(ii) there is no reasonable prospect for rescuing the company; or

(iii) the company has failed to satisfy the procedural requirements;

(b) **setting aside the appointment of the practitioner**, on the grounds that the practitioner—

- (i) does not satisfy the requirements of the Act;
- (ii) is not independent of the company or its management; or
- (iii) lacks the necessary skills, having regard to the company's circumstances; or

(c) requiring the practitioner to provide security in an amount and on terms and conditions that the court considers necessary to secure the interests of the company and any affected persons.

It is a heavy burden for a creditor to apply to court with notice to all the affected persons.

3.3. Unless a company has adopted a resolution to begin business rescue, an affected person may apply to a court at any time with notice to each affected party "in the prescribed manner" (prescribed manner not made public) for an order placing the company under supervision and commencing business rescue proceedings.

3.4. If a company's business rescue proceedings have not ended within three months after the start of those proceedings, or such longer time as the court, on application by the practitioner, may allow, the practitioner must—

- (a) prepare a report on the progress** of the business rescue proceedings, and update it at the **end of each subsequent month** until the end of those proceedings; and
- (b) deliver the report and each update in the prescribed manner to each affected person, and to the court, if the proceedings have been the subject of a court order, or the Commission (successor to Registrar of Companies) in any other case.**

3.5. Moratorium

During business rescue proceedings, **no legal proceeding**, including enforcement action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or proceeded with in any forum, **except with the written consent of the practitioner; or with the leave of the court** and in accordance with any terms the court considers suitable. **Set-off is allowed** against any claim made by the company in legal proceedings before or after commencement of the business rescue proceedings.

3.6. Post commencement finance

During business rescue proceedings the company **may obtain finance secured by the assets** of the company, but payable after costs related to the proceedings and claims related to employment arising during the rescue proceedings.

3.7. Effect on contracts

3.7.1. Despite any provision of an agreement to the contrary, during business rescue proceedings, **the practitioner may cancel or suspend** entirely, partially or conditionally any provision of **an agreement** to which the company is a party at the commencement of the business rescue period, other than an agreement of employment. This applies subject to insolvency law provisions dealing with agreements on a securities exchange or in accordance with standard terms published by the International Swaps and Derivatives Association, the International Securities Lenders Association, the Bond Market Association or the International Securities Market Association, or any similar agreement.

3.7.2. Any **party to an agreement that has been suspended or cancelled may assert a (concurrent) claim against the company only for damages.**

3.7.3. **Employment agreements can only be amended** to the extent that changes occur in the ordinary course of **attrition**; or where the employees and the company, in accordance with applicable labour laws, **agree different terms and conditions.**

3.8. Protection of property interests

If, during a company's business rescue proceedings, the company wishes to dispose of any property over which another person has any **security or title interest**, the company must obtain the **prior consent of that other person, unless the proceeds** of the disposal would be **sufficient to fully discharge** the indebtedness protected by that person's security or title interest; and promptly pay to that other person the sale proceeds attributable to that property up to the amount of the company's indebtedness to that other person; **or provide security for the amount of those proceeds, to the reasonable satisfaction of that other person.**

3.9. Proceedings by practitioner

3.9.1. If, at any time during business rescue proceedings, the practitioner concludes that—

(a) there is **no reasonable prospect for the company to be rescued**, the practitioner must—

- (i) so inform the court, the company, and all affected persons in the prescribed manner; and
- (ii) apply to the court for an order discontinuing the business rescue proceedings and placing the company into liquidation;

(b) there **no longer are reasonable grounds to believe that the company is financially distressed**, the practitioner must so inform the court, the company, and all affected persons in the prescribed manner, and—

- (i) if the business rescue process was confirmed by a court order, or initiated by an application to the court apply to a court for an order terminating the business rescue proceedings; or
- (ii) otherwise, file a notice of termination of the business rescue proceedings.

3.9.2. **If there is evidence, in the dealings** of the company before the business rescue proceedings began, of—

(i) **voidable transactions**, or a failure by the company or any director to perform any material obligation relating to the company, the practitioner must direct the management to take any necessary steps to rectify the matter;

(ii) **reckless trading**, fraud or other contravention of any law relating to the company, the practitioner must—

(aa) forward the evidence to the appropriate authority for further investigation and possible prosecution; and

(bb) direct the management to take any necessary steps to rectify the matter, including recovering any misappropriated assets of the company.

This is a remarkable provision: Why refer matters for further action to the members of management who are usually the guilty parties or beneficiaries of voidable transactions? The insolvency provisions for voidable transactions and machinery to gather information or evidence are not made applicable to business rescues.

3.10. **First meeting**

3.10.1. Within 10 business days after being appointed, the practitioner must convene, and preside over, a first meeting of creditors, at which the practitioner must inform the creditors **whether the practitioner believes that there is a reasonable prospect of rescuing the company**; and may receive proof of claims by creditors.

3.10.2. The creditors may determine whether or not a committee of creditors should be appointed and, if so, may appoint the members of the committee.

3.10.3. At any meeting except where the proposed rescue plan is considered (see below) a **simple majority** carries the day.

3.11. Approval of plan

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

3.11.2. The Act contains detailed provisions of the information which must be contained in a proposed plan.

3.11.3. The **business rescue plan must be published by the company within 25 business days after the date on which the practitioner was appointed, or such longer time as may be allowed by the court** on application by the company, **or the holders of a majority of the creditors' voting interests.**

3.11.4. **A rescue plan is adopted 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.**

3.11.5. **A secured or unsecured creditor has a voting interest equal to the value of the amount owed to that creditor** by the company. There are intricate rules to determine the voting interest of a concurrent creditor who would be subordinated in liquidation proceedings.

3.11.6. The practitioner must determine in accordance with intricate rules whether a creditor is independent.

3.11.7. There are **special provisions for the rights of employees.** To the extent that any remuneration, reimbursement for expenses or other amount of money relating to employment became due and payable by a company to an employee at any time before the beginning of the company's business rescue proceedings, and had not been paid to that employee immediately before the

beginning of those proceedings, the employee is a "**preferred unsecured creditor**" (not defined anywhere) of the company.

3.11.8. An **adopted plan is binding on all creditors and securities holders.**

3.11.9. **Debts are discharged once a plan is implemented unless the plan provides otherwise.**

3.12. Rejection of plan

3.12.1. If a business rescue plan has been rejected the **practitioner may seek a vote of approval from the holders of voting interests to prepare and publish a revised plan; or** advise the meeting that the company will **apply to a court to set aside the result of the vote by the holders of voting interests** or shareholders, as the case may be, on the grounds that it was "**inappropriate**".

3.12.2. **If the practitioner does not take such action any affected person** present at the meeting **may call** for a vote of approval from the holders of voting interests requiring the **practitioner to prepare and publish a revised plan**; or apply to the court to set aside the result of the vote by the holders of voting interests or shareholders, as the case may be, on the grounds that it was "**inappropriate**".

3.12.3. **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.

3.12.4. **If no person takes any of these actions the practitioner must promptly file a notice of the termination of the business rescue proceedings.**

4. **Compromise with creditors in terms of the new Companies Act**

4.1. 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 of any class of its creditors at a meeting convened with notice to the creditors and the Commission (successor to the Registrar of Companies).

4.2. The Act has detailed provisions on the contents of the proposal.

4.3. 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.

4.4. If a proposal is adopted the company may **apply to the court for an order approving the proposal**; and the court, may sanction the compromise as set out in the adopted proposal, if it considers it just and equitable to do so, having regard to

4.4.1. 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;

4.4.2. and in the case of a compromise in respect of a company being wound up, the report of the Master on suspected contraventions or offences and whether or not any director or officer or past director or officer of the company is or appears to be personally liable for damages or compensation to the company or for any debts or liabilities of the company.

4.5. 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 (successor to the Registrar of Companies).

4.6. These provisions improve the existing provisions which require at least two court applications.

5. History and background of insolvency reform

5.1. Following reports by the South African Law Reform Commission in February 2000 and the Standing Advisory Committee on Company Law in October 2000, a Bill based on recommendations in the reports was submitted to Cabinet. During March 2003 Cabinet approved the submission of the Insolvency and Business Recovery Bill, 2003 to Parliament for consideration during the 2003 session of Parliament.

5.2. The Bill was submitted to the State Law Advisers during April 2003 for certification (a prerequisite before any legislation may be tabled in Parliament). The State Law Advisers completed a draft during March 2004, but the Bill was held back for instructions on the inclusion of modern provisions dealing with business rescue.

5.3. In June 2005 Cabinet approved the establishment of an Inter-Departmental Task Team to look into aspects raised by the Ministerial Committee of Enquiry into the Liquidations Industry. It was concluded by the Task Team that the Department of Trade and Industry ("DTI") should take responsibility for the reform process in the area of business rescue.

5.4. As mentioned above, DTI has promoted a new Companies Act which contains business rescue provisions for companies. (Business rescue provisions for natural persons, partnerships and trusts must still be developed.) Now that this stumbling block has been removed, it is expected that steps to table new insolvency laws in Parliament will be revived as soon as the NEDLAC process has been finalised.

5.5. **NEDLAC process**

5.5.1. During 2003 the Insolvency and Business Recovery Bill was referred to the National Economic Development and Labour Council (NEDLAC).¹

5.5.2. NEDLAC appointed a Task Team to look at the Bill. The Task Team started its consideration of the Bill after it was decided that DTI would take responsibility for business rescue. The Task Team finalised its consideration of the Bill at 6 meetings held from July to November 2007.

5.5.3. As soon as a NEDLAC report on the Bill has been finalised the Bill will be resubmitted to Cabinet.

6. **Main features of the insolvency reform**

6.1. The main aim of the insolvency review was to **balance and satisfy the needs of the different stakeholders**. The major stakeholders are the commercial community in general (creditors and workers in particular), insolvent debtors, insolvency practitioners and the Government. Because of conflicting interests it is often difficult to strike a fair balance between the different interests.

6.2. **Effective, speedy and fair procedures** are important needs of stakeholders and formed the basis for the review. The value of reforms of a practical or technical nature should not be underestimated. It is in the interest of the economy and society as a whole that insolvency problems should be solved fairly and efficiently. For instance, a seemingly innocuous proposal that directions by creditors should be obtained early in the liquidation process is expected to have a marked effect on

¹ This Council was established by Act 35 of 1994 to represent organised business, organised labour and Government. One function of the Council is to consider all significant changes to social and economic policy before it is implemented or introduced in Parliament.

finalising insolvencies and limiting the time that funds are caught up in insolvent estates - especially in difficult economic times it is important that money should be available to generate growth and should not be entangled in tiresome and time-consuming procedures.

6.3. The following are the **more substantive changes** proposed to the existing position, amongst the many technical changes recommended in the report of the Law Reform Commission:

6.3.1. Only a person who is a member of a **professional body recognised by the Minister** responsible for justice may be appointed as liquidator.

6.3.2. **Liquidators may preside at meetings** of creditors unless questioning is to take place at the meeting or an interested party requests that the Master of the High Court² or a magistrate should preside.

6.3.3. **Resolutions can be adopted at the first meeting** which is now convened by the initial liquidator as soon as possible after his or her appointment and not by the Master of the High Court³ after the final sequestration order.⁴

6.3.4. A creditor under a financial lease agreement is treated as a secured creditor and must prove a claim.

6.3.5. It was recommended that many of the preferent claims (for instance for taxes) should be abolished but this recommendation was not accepted by Government.

6.3.6. In respect of **dispositions before liquidation that may be set aside, wider provisions apply to associates of the insolvent** than to other persons and it is presumed for all dispositions, until the contrary has been proved, that a debtor's liabilities exceeded his or her assets at any time within three years before the liquidation of the estate.

6.3.7. Provision is made for a **binding composition between a natural person debtor and a majority of creditors without an application to declare a debtor's estate insolvent.**

6.4. Uniform provisions

6.4.1. Insolvency legislation is interspersed in a number of Acts. The Insolvency Act 24 of 1936 forms the basis of insolvency legislation, but only

² See next footnote.

³ The Master is a Department of Justice official, not connected to the High Court, who regulates the administration of insolvencies and other matters.

⁴ The local equivalent of a declaration of bankruptcy.

finds application in respect of individuals and partnerships. Where a company or close corporation is being wound up the relevant provisions must be found in the Insolvency Act, the Companies Act 61 of 1973 or the Close Corporations Act 69 of 1984⁵ according to intricate rules. This makes the legislation inaccessible and leads to problems in practice. Although there are material differences between individual and juristic persons not all differences between the requirements and procedures for the winding-up of juristic persons and individuals are justified. **Uniform provisions are recommended, but provisions justified by fundamental differences between juristic and natural persons should be retained.**

6.4.2. Besides the Companies Act and the Close Corporations Act there are a number of other legislative provisions dealing with the liquidation of specific types of institutions, for instance banks, insurance companies and pension funds. It is recommended that the uniform legislation should apply to the liquidation of these institutions as well, but the powers conferred on governing bodies in respect of the winding up of specialised institutions have been retained.

⁵ The Close Corporations Act was passed to provide for small or simple corporate entities.