

**AN EXAMINATION OF INSOLVENCY ALTERNATIVES
FOR CORPORATE AND NON CORPORATE ENTITIES
IN SOUTH AFRICA**

By

CHINWE CHIWETE

REG NO:10180584

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SUMMARY

The journey towards insolvency is often a gradual process, thus enabling a business or person in most circumstances to be aware of the danger ahead if adequate precautions are not taken. This position is recognized by the Statute, hence the definition given to a financially distressed company under the Companies Act¹ to mean inability to pay all its debts within the immediately ensuing six months or the likelihood of going insolvent within the immediately ensuing six months.

Rescue mechanisms are therefore aimed at ensuring that when faced with the signs of insolvency, a business for instance can be properly driven to become solvent again or at least restructured to achieve better realization of assets.² Indeed, providing alternatives to insolvency is fast becoming a global trend as many countries now appreciate the need to give a person or business experiencing difficult times, the opportunity to rise again without necessarily going through the rigors of liquidation or sequestration.

South Africa is not left out in the quest to assist over-indebted persons and provide them with alternative measures beside insolvency. The National Credit Act³ for instance seeks as one of its objectives to prevent over-indebtedness and where it occurs address same by means of debt rearrangement. This is in addition to certain provisions of the Magistrate Court

¹Section 128(1)(f) of Companies Act 71 of 2008.

² Section 128 (1)(b) (iii) recognize that business rescue includes the development and implementation of a plan by restructuring its affairs, business in a manner that maximizes the likelihood of the company continuing in on a solvent basis or if not possible result in better return to the creditors or shareholders than would result from immediate liquidation of the company; Section 8 (3)(d) of the UK Insolvency Act 1986 provides similar purpose for Administration order applicable in UK.; Smits (1999) 32.

³ 34 of 2005.

Act⁴ which allow a debtor the option of applying for an administration order and where granted make payment in instalments. The Companies Act also provides for business rescue as well as compromise between company and creditors.⁵

This research in brief analyses the above mentioned laws in South Africa that provide alternative measures for financially troubled or over-indebted debtors as applicable to corporate and non-corporate entities. The research considers whether these laws are sufficient to assist debtors in financial crisis, the effectiveness of these laws, challenges as well as loopholes taking into consideration what is applicable in other jurisdictions such as the United States, United Kingdom, Canada and Australia.

The end of this research contains recommendations that would assist in achieving effective rescue mechanisms or alternatives to insolvency beneficial to both corporate and non-corporate entities in South African.

KEY TERMS

Administration; Arrangement; Business rescue; Business restructuring; Composition; Compromise; Credit; Debt re-arrangement; Discharge; Financial crisis; Financially distressed; Rescue mechanisms; Rescue practitioners; Reorganisation.

⁴ 32 of 1944

⁵ Sections 128-155

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CHAPTER 1

INTRODUCTION

1.1 General Overview

It is said that society should not reward the cautious man who buries his talent and takes no chances; but should do everything in its power to assist the man who creates jobs and who strives to turn his one talent into ten-even if he fails in the attempt.¹

With the above in mind, many countries have tried to reform their insolvency laws with the aim of assisting debtors in financial difficulties. The idea is to have other options available to such debtors besides bankruptcy. The US is at the fore-front of this reform having recognised early enough that when hard times hit a person or a company, a chance to fix it would be more appropriate than punishment.²

The South African Insolvency law³ as presently constituted is creditor friendly which further explains the “advantage to creditors’ requirement” as condition precedents for the granting of sequestration.⁴ It seems, however, that South Africa appreciates the global move towards rescuing debtors in financial crisis, hence the promulgation of certain legislation to assist over-indebted consumers.

This research intends to consider the various laws in South Africa on rescue provisions, the challenges with those laws as well as ways of addressing same. Thus, the key questions are: does South Africa have laws to assist corporate and non-corporate debtors in financial difficulties besides declaring bankruptcy, what are those laws and how efficient are they? How can those laws be improved taking into consideration global reforms on rescue provisions as applicable in certain advanced jurisdictions?

To address the above questions meaningfully, this research would in this chapter set the scene by way of general overview to include the use of credit facility and its relationship with insolvency. In addition, the necessity or need for rescue provisions will be considered to further portray the rationale behind developing alternatives to bankruptcy.

¹Michael Rochelle “Lowering the penalties for failure: using the insolvency law as a tool for spurring economic growth; the American experience, and possible uses for South Africa.” *TSAR* 1996 page 315

²*Ibid.*

³Insolvency Act 24 of 1936.

⁴Sections 6 and 10 of Insolvency Act.

Chapter 2 of this research will consider the various ways of rescuing corporate or non-corporate entities from financial difficulties ranging from formal to informal procedures. Particularly, preventive measures as well forms of rescue provisions will be discussed.

It is intended in Chapter 3 to discuss the various South African Laws on rescue provisions and how they assist over-indebted consumers. Whilst Chapter 2 looks at the various forms of rescue provisions globally, Chapter 3 zooms into the South African laws in particular. The laws to be considered would include the Insolvency Act,⁵ Companies Act,⁶ Magistrate Court Act⁷ and the National Credit Act.⁸ The loopholes in these laws will be determined alongside recommendations.

Chapter 4 will give a comparative analysis taking into consideration what is applicable in other jurisdictions. The United States and United Kingdom approach would be discussed in addition to the Australian position. The rationale is to show how those jurisdictions have addressed some of the loopholes identified in Chapter 3.

The outcome of this research will be summarized in the last chapter with detailed recommendations on the way forward for South Africa.

⁵ 24 of 1936

⁶ 71 of 2008

⁷ 32 of 1944

⁸ 34 of 2005

1.2 *Setting the Scene*

1.2.1 **Provision of Credit As A Basis for Insolvency Law**

If goods were to be sold and bought only on a cash basis and no form of credit required, perhaps, one would not arrive at a situation where the sum of unsatisfied liabilities exceed the sum of available assets.⁹ The same position will hold where trade by barter is used as a medium for sales and purchases.¹⁰ It is also recognised that even in such a credit-free state society as the scenario created above, an individual or company could still encounter economic ruin as a result of adverse claims of contractual nature or liability to pay substantial compensation for tortuous injuries.¹¹ Despite the validity of the above assertion, the fact remains that without credit transactions, the need to develop insolvency law may not be too necessary. Such an insolvency law even when in existence would not be fully maximized as there are no debtor/creditor relationships to create the circumstances of insolvency. One therefore agrees with the logic that bankruptcy is a response to credit,¹² an assertion that is further confirmed by the history of bankruptcy.¹³

It must be emphasized at this point that the use of cash payment is fast declining and credit is taking its place at least in most developed and developing economies. Several advantages have been identified in the use of consumer credit which include the fact that consumers could enjoy capital goods sooner than would otherwise be possible and in inflationary times, possibly more cheaper; the fact that some consumers find it easier to borrow and pay back rather than save up; and the practical convenience associated with the use of credit.¹⁴ As stated earlier, consumer credit offered advantages to the individual that was both monetary and non-monetary and therefore it could be argued that it contributed to a better allocation of resources by increasing both consumer satisfaction and economic efficiency.¹⁵

In addition, the hallmark of a capitalist state is the private sectors participation in the ownership and control of trade.¹⁶ Such private participation may not be achievable without

⁹ IAN Fletcher *The Law of Insolvency* (2009)3

¹⁰ *Ibid*

¹¹ *Ibid*

¹² Thomas Jackson *The Logic and Limits of Bankruptcy Law* (1986)7

¹³ 'The word "bankruptcy" originates from "*bancarupta*" which describes the medieval custom in the Italian city states of breaking the benches of bankers and tradesmen who absconded with the property of the creditor; Tolmie *Corporate and Personal Insolvency Law* (2003) 8; UK Bankruptcy Act 1542.

¹⁴ The Review Committee Report on *Consumer Credit Cmnd 4596* (1971); Tolmie 17.

¹⁵ *Ibid*.

¹⁶ Capitalism is an economic and political system in which a country's trade and industry are controlled by private owners for profit, rather than by state. Judy Pearsall (ed) "The Concise Oxford Dictionary 10th Edition."

free access to credit and where there is no access to credit, the government's vision of employment for majority may not be realized.¹⁷ This explains the necessity of the many policies and laws now in place to facilitate the use of credit and reduce the hardship of debtors in terms of interest and payment obligations.¹⁸ Credit is no longer perceived as evil but as an acceptable means of livelihood which is highly encouraged as a means of achieving economic growth and efficiency.

1.2.2 Insolvency Law

1.2.2.1 Introduction

Although the use of credit and its advantages have been canvassed above, one should bear in mind that once inability to pay debt occurs, the debtor is faced with a major challenge as commercial insolvency has set in, thus Insolvency Law comes into play. The law of insolvency therefore consists of laws that regulate debtors who are unable to pay their debts.¹⁹ It provides the procedures for distributing the assets or proceeds of the assets of the debtor that is unable to pay his debts in favour of his creditors. By virtue of Insolvency Law, a country is able to set out mechanisms for determining the fate of the debtor from the moment he²⁰ fails the solvency test to the granting of an insolvency order, right through the administration of the estate, to the realisation of assets and distribution to creditors. Unlike other debt collection laws, Insolvency law is designed to ensure that the inadequate assets of the debtor are fairly distributed amongst his creditors, hence the saying that Insolvency Law involves a contest among creditors all of whom are staking claims to an inadequate pie, rather than a contest between debtors and creditors.²¹

1.2.2.2 South African Insolvency Law

It should be mentioned that in South Africa, instituting insolvency procedure is not the only option available to the creditor where the debtor is unable to pay him. He could for instance, demand payment and where such demand is not responded to, issue summons and obtain

¹⁷On the 10th of February 2011, President Jacob Zuma in his State of the Nation address emphasized on government's focus to create jobs in South Africa and the important role of private sectors to help achieve that goal. According to him, government would establish a job fund of R9 billion over the next three years in order to finance job creation while private sector would get tax breaks in order to assist job growth.

¹⁸In South African for instance, the National Credit Act (NCA), 34 of 2005 and Consumer Protection Act,(CPA) 68 of 2008 have protective measures in favour of debtors.

¹⁹ John Duns *Insolvency Law and Policy* (2002) 1; Nagel also defined Insolvency Law as the totality of rules regulating the situation where a debtor cannot pay his debts or where his total liabilities exceed his total assets. Nagel *Commercial Law* (2006) 402.

²⁰The word "He" as used refers to both genders.

²¹John Duns 1.

civil judgment. He may thereafter by means of warrant of execution attach the property of the debtor if the debtor fails to settle the judgment. The attached assets can be sold and the creditor entitled to claim from the proceeds of the sale.²² The creditor can also explore the garnishee option or obtain an emoluments attachment order in terms of which the court orders a portion of the debtor's salary to be paid to him.²³

The Insolvency Act 24 of 1936 is the principal source of South African Insolvency Law. The Act applies essentially to individuals, partnerships and any other body that cannot be wound up under the Companies Act.²⁴ In 1987, the South African Law Commission commenced the review of the said law which culminated in a draft Bill in 2000.²⁵ In 2003, the idea of a unified Insolvency Bill dealing with debtors as contained in the Insolvency Act, corporate and other entities in other words comprising of all kinds of debtors was approved by Cabinet.²⁶ A formal Bill has not been published yet but the Department of Justice now has a working document dated 30th June 2010 which contains a unified bill titled Draft Insolvency and Recovery Bill.²⁷

Although the 1936 Act is the principle source of Insolvency Law, it is not the only source in view of the Companies Act²⁸ and Close Corporations Act²⁹ which provide for winding up of companies and close corporations respectively. The Companies Act of 1973 has been repealed by the Companies Act 2008.³⁰ But in terms of item 9 Schedule 5 of the 2008 Act, some sections of Chapter 14 of the repealed Act continue to apply subject to the stipulated limitations.

In addition to the above mentioned laws, there exist certain legislations that apply to winding up of entities such as banks and insurance companies. Judgments of the high court including

²²*Ibid*; Bertelsmann *The Law of Insolvency in South Africa* (2008) 1.

²³*Ibid*.

²⁴The Insolvency Act of 1934 defined "debtor" in connection with the sequestration of the debtor's estate to mean a person or partnership or the estate of a person or partnership which is a debtor in the usual sense of the word, except a body corporate or a company or other association of persons which may be placed in liquidation under the law relating to Companies.

²⁵Bertelsmann 4; Boraine "Elements of South African Insolvency Law" (2011) UP IIL, 2.

²⁶Boraine *supra* 3.

²⁷*Ibid*.

²⁸61 of 1973.

²⁹69 of 1984.

³⁰71 of 2008.

Constitutional Courts as well as common law principles are all important sources of South African Insolvency Law.³¹

1.2.3 Rescue Mechanisms, Necessity and Impact.

1.2.3.1 Understanding Rescue Mechanisms

The above shows that the use of credit goes with the possibility of default or inability to pay debt. Such scenarios have developed insolvency law in the sense that where there are debts, inability to pay debts will occur and where there are inabilities to pay debts; laws and regulations dealing with such situations of which insolvency law is one would be in place. As stated in the Cork Report, one of the aims of a good modern insolvency law is to recognise that the world in which we live and the creation of wealth depend on a system founded on credit and that such a system requires as a correlative, an insolvency procedure to cope with its casualties.³²

Modern insolvency law should be able to diagnose and treat an imminent insolvency at an early rather than at a late stage and provide means for the preservation of viable commercial enterprises capable of making a useful contribution to the economic life of the country.³³ Not all debtors that falter or experience serious financial difficulty in a competitive marketplace should necessarily be liquidated; a debtor with a reasonable prospect of survival (such as one that has a potentially profitable business) should be given that opportunity where it can be demonstrated that there is greater value (and, by deduction, greater benefit for creditors in the long term) in keeping the essential business and other component parts of the debtor together.³⁴

Rescue mechanisms or provisions are therefore the various means of rescuing a debtor or business from becoming insolvent or achieving a better realisation of assets.

³¹Nagel *supra* 403.

³² Report of the Insolvency Law Review Committee on *Insolvency Law & Practice* Cmnd 8558 (1982) (Cork Report) Para 198.

³³ Cork Report Par 198.

³⁴ 27, par 24.

1.2.3.2 Need for Rescue Mechanisms

There are so many reasons why both the debtor and creditor may wish to avoid insolvency. The debtor for instance may want to avoid the stigma attached to insolvency or to avoid the legal consequences it entails.³⁵ The creditor on the other hand may wish that the debtor continues in business in the hope that the debtor would trade out of difficulties and provide better returns that would not have been realised if the debtor had gone insolvent or perhaps the creditors wish to avoid the cost associated with bankruptcy.³⁶ The fears of the creditors that they may end up getting no returns are understandable in view of survey conducted in the office of the Master Pretoria which shows that concurrent creditors receive dividend in only 28.6% of sequestration and in 40.6% made contributions.³⁷

Rescue mechanisms play important roles in enhancing economic efficiency. Apart from the fact that jobs are preserved, business owners are more willing to take business risk in terms of investments and purchases. Further advantage of corporate rescue has been identified to include the fact that it is also one of the factors that foreign investors take into consideration in deciding to invest.³⁸

In conclusion, the importance of rescue mechanisms can therefore not be over-emphasised. For the debtor, it is of paramount importance to stay solvent and for the creditors a better deal than insolvency will provide and for the society stability and economic efficiency.

³⁵John Duns 414-415.

³⁶*Ibid*

³⁷*Exparte Stenkamp (1996) 3 SA 822.*

³⁸Loubser “*Some Comparative Aspects of Corporate Rescue in South African Company Law (LLD 2010) Unisa 1-2*

CHAPTER 2

RESCUE MECHANISMS FOR CORPORATE AND NON-CORPORATE ENTITIES AS APPLICABLE IN MODERN DAY SOCIETIES

Introduction

The idea of limiting rescue provisions to companies only is misconceived. Both corporate and non-corporate entities contribute to economic growth and as such deserve equal or near equal treatment in terms of rescue provisions. South Africa is a classic example of a jurisdiction that has paid more attention to rescue mechanisms that would apply to corporate entities with the least emphasize on non-corporate entities as seen from the Companies Act 2008.

The research is not limited to providing solutions for only corporate entities. It intends to take a wholistic approach to rescue mechanisms and the idea is to show various options available to corporate and non-corporate entities that are facing with financial challenges. Such consideration is necessary and would assist the draftsmen in determining the areas of South African Law that require further amendments.

It should be noted that the options below are not limited to what is obtainable under South African Law. Certain provisions applicable in United States and United Kingdom are considered. The choice of US and UK is motivated in Chapter 5 of this research dealing on comparative analysis.

The outlines under this Chapter are set out as follows:

- 2.1 Preventive measures
- 2.2 Informal rescue procedures
- 2.3 Formal rescue procedures

2.1 *Prevention measures*

It has been identified that reckless investment, poor management decisions and ineffective risk control measures may contribute to a subsequent adverse financial situation resulting in an inability to pay debts.³⁹ In addition, inadequate financial and cost control, unpreparedness for business cycles, uncommitted short-term borrowing vulnerable to business down-turns instead of long-term committed finance and imprudent acquisitions or business ventures have all been identified as causes of bankruptcy.⁴⁰

The point then is that prevention is better than cure.⁴¹ Whilst the Act considers reckless lending to involve granting credit to a consumer without conducting due diligence as per the credit commitment of that consumer and whether he/she can afford the new credit,⁴² in my view reckless borrowing should include knowingly taking more credits than one can afford to service. This is more so in view of the fact that the consumer understands his financial situation better than the credit provider despite any due diligence that may be undertaken by the credit provider. My opinion is therefore that a consumer should assess his financial position and properly determine whether the credit he further intends to take is affordable or not in terms of servicing or otherwise. Perhaps, that is the intention of the Act in achieving the purpose of promoting responsibility in the credit market by encouraging responsible borrowing.⁴³

2.2 *Informal Rescue Procedures*

The informal procedure would entail contacting your creditor to work out the best payment solution based on your financial situation. Such informal negotiation may include re-negotiating the loan or period of payment or reduction of interest rate depending on the concession the creditor is willing to give. To my mind, the only challenge in utilizing this procedure is the fact that it is not too reliable in terms of facilitating the rescue mechanism. Sometimes creditors are not willing to give any of the above concession on an informal basis and those creditors that eventually oblige may end up renegeing on their promises, thus leaving the debtor in a worst state. Also as pointed out the unanimity required of creditors

³⁹ Wood *supra* 9.

⁴⁰ *Ibid.*

⁴¹ INSOL International “Consumer Debt Report: Report of Findings and Recommendations” (2001) The Committee’s report supports the view that the solution to overspending and over-indebtedness can be found in the idea that prevention is better than cure. <http://www.insol.org/pdf/consdebt.pdf>.

⁴² Section 80 of NCA defines reckless credit.

⁴³ Section 3 (c) of the NCA.

also poses a problem because it means that such an informal arrangement is likely to be viable where creditors are many.⁴⁴

That having been said, informal proceedings can be useful and as stated, there is a general recognition that informal arrangements with creditors, restructuring and rescue are ultimately of more benefits to a company and more importantly its creditors.⁴⁵

2.3 Formal Rescue Procedure

It is important to mention that not all the procedures mentioned below strictly form part of rescue mechanisms provided in terms of insolvency laws. Indeed, few are regulated by different legislations but with the resultant effect of rescuing debtors in financial difficulties, hence their consideration under this category.

The formal rescue procedures as applicable could take any of the following shape:

- 2.2.1 Composition with creditors which would require the consent of a certain percentage of creditors.⁴⁶In terms of the Close Corporations Act for instance,⁴⁷ an application may be made to court where the composition is accepted for setting aside of winding up order.⁴⁸
- 2.2.2 Debt rearrangement or arrangement with creditors: this involves a debt rearrangement with your creditors. Usually the debt rearrangement includes reducing interest rates, extending payment periods, or discounting the credits. An example of this is section 86 of the NCA which empowers a debt counsellor to make payment proposal to creditors on behalf of the debtor. The agreed proposal is subsequently filed as a consent order to be confirmed by the National Consumer Tribunal.⁴⁹ The administration order pursuant to the Magistrate Court Act⁵⁰ can also be classified under this category as debts are paid in instalments as ordered by the court.

⁴⁴Duns *supra* 419.

⁴⁵ James Silenat *The Law of International Insolvencies and Debt Restructuring* (2006)110.

⁴⁶ Bertelsmann *supra* 546.

⁴⁷ 69 of 1984.

⁴⁸ Section 72(11).

⁴⁹ The National Consumer Tribunal “NCT” is established pursuant to section 26 of the NCA to adjudicate on applications made to it in terms of the Act.

⁵⁰ 32 of 1944.

2.2.3 Arrangement and Administrative procedures: An example is the Voluntary Arrangement and Administrative procedures under the UK insolvency Act⁵¹ and the Judicial Management under the 1973 Companies Act of South Africa

2.2.4. Reorganisation or Business restructuring: This will include reorganization under Chapter 11 of the *Bankruptcy Reform Act 1978*⁵² which is available to both corporate and non corporate entities.

2.2.4.1 Business restructuring in this context would also include every form of restructuring or reconstruction capable of saving a business and the list is not exhaustive. In my view, it would include Arrangement and Compromise in terms of sections 311 and 313 of the Companies Act 1973 and 155 of the 2008 Act⁵³ otherwise known as a Scheme of Arrangement which allows for compromise between a company and its members, business rescue in terms of Chapter 6 of the Companies Act 2008.

2.2.4.2 Mergers and Acquisitions or buyouts could also fall into this category having been accepted as appropriate vehicles for corporate growth.⁵⁴ Rather than liquidation, two companies in similar industries could merge to overcome financial challenges.⁵⁵ The merged businesses result in the existence of more viable companies which can absorb more employees. Although mergers and acquisitions or buyouts as well as recapitalization are not specifically listed as rescue mechanisms, one is of the view that in the broader context of the objectives of rescue mechanisms which is rescuing a business to become successful again or at least achieving better realization of its assets that would not have been possible under liquidation, those may play important roles in restructuring of a company. It may therefore be a viable option for a company that is experiencing financial challenges to merge with a similar company or be acquired by a stronger company. This would not only assist the company in avoiding liquidation in terms of insolvency law but also safeguard the interest of its creditors as well as its employees.

⁵¹ 1986

⁵² Referred to as Bankruptcy Code.

⁵³ 61 of 1973 and 71 of 2008.

⁵⁴ Dennis Block "Public Company M &A: Recent Developments in Corporate Control, Protective Mechanisms and Other Deal Protection Techniques" *Euromoney Legal Training "Mergers & Acquisitions" (2008)* 6.

⁵⁵ *Ibid.*

Chapter 11 of the Code envisages the possibility of closing ineffective operations or sale of assets.⁵⁶ Indeed, in achieving business rescue objective, acquisition or buyout may in certain instances form part of the rescue plan.

⁵⁶Bankruptcy Reform Act of 1978; KPMG 386.

CHAPTER 3

THE DIFFERENT LAWS ON RESCUE MECHANISMS THAT ARE AVAILABLE TO CORPORATE AND NON-CORPORATE ENTITIES IN SOUTH AFRICA

Introduction

Having considered different forms of rescue provisions as represented under formal and informal procedures above, it will be paramount to look into South African laws and determine those laws that provide debt reliefs or alternatives to bankruptcy for over-indebted consumers. This chapter therefore will explore the current Insolvency Act⁵⁷ and Companies Act of South Africa⁵⁸ as well as their rescue provisions if any. In addition, certain laws that provide for alternative debt relief measures outside Insolvency Act will also be considered.

Chapter 3 would be considered under the following headings:

The Insolvency Act

Companies Act 2008

The Magistrate Court Act⁵⁹

The National Credits Act⁶⁰

⁵⁷ 24 of 1936

⁵⁸ 71 of 2008

⁵⁹ 32 of 1944

⁶⁰ 34 2005

3.1 *The Insolvency Act*

South African Insolvency Act applies to a person, partnership or their estates, Trust, Club and Companies where they cannot be liquidated in terms of the Companies Act.⁶¹ The Act essentially regulates the affairs of those debtors from the time of filing the application for sequestration to the granting of the order and subsequent administration of their estates. The main aim of a sequestration order therefore is to ensure the orderly and equitable distribution of assets of a debtor where such assets are insufficient to meet the claims of all his creditors.⁶²

In terms of the Insolvency Act, the closest to a rescue mechanism is section 119 to the extent that rescue mechanism encompasses the rescue of an entity or person from going bankrupt or at the minimum better realisation of assets that would have been achieved in liquidation or sequestration. The assumption here is that perhaps, section 119 compositions even though utilized after sequestration may offer better realisation of assets than would have been achieved under sequestration.

The section 119 composition allows a debtor who has been sequestrated to make an offer of composition after the first meeting. In terms of section 119, if the offer is accepted by creditors whose votes amount to not less than three-fourth in value and number of the votes of all the creditors who proved claims against the estate, and payment under the composition has been made or security for such payment has been given under the Composition, the insolvent shall be entitled to a certificate by the Master of the acceptance of the offer. The Master's certificate is a basis for an earlier application for rehabilitation of the debtor in terms of section 124. It is submitted that the application of section 119 after sequestration constitutes a major challenge and clearly shows its loopholes. Besides the statutory requirements of section 119, an insolvent person can explore the common law composition. This unlike the statutory composition will require the consent of all creditors as the decision of the majority cannot bind the dissenting minority,⁶³ thus posing some challenges as well.

As regards the close corporations, the composition provision under the Act⁶⁴ also applies after commencement of liquidation and as such has similar fate with section 119 composition

⁶¹ See definition of "debtor" under section 2 of the Act; section 3 of the Act; *Magnum Financial Holding (Pty) Ltd v. Summerly* 1984 (1) SA 160 (W); *Lawclaims (Pty) Ltd v. Rea Shipping Co SA* 1979 (4) SA 745.

⁶² *Sharrock et al Hockley's Insolvency Law* (2007) par.1-2.

⁶³ *Bertelsmann* 546-547.

⁶⁴ 69 of 1984. The Close Corporations may eventually phase out in terms of Schedule 2 of Companies Act 2008. New Close Corporations will not be registered, while any of the existing ones may chose to convert to a company. The Companies Act did not repeal the Close Corporation Act which means that the Act will continue

even though, by virtue of Close Corporations Act, an offeror may apply to the court for the setting aside of the winding up if the accepted offer of composition so provides.⁶⁵

It follows that South Africa still needs a suitable alternative debt relief measures outside the ambit of insolvency law⁶⁶.

3.2 *Companies Act 2008*

3.2.1 **Prior to the 2008 Act**

The following major challenges were identified by learned authors⁶⁷ with judicial management under the 1973 Companies Act.

1. The traditional practice of appointing professional liquidators as judicial managers of companies whereas the objectives of these persons are opposed.⁶⁸
2. The heavy reliance of judicial management on court procedures makes its expensive, a less formal procedure was recommended.⁶⁹
3. The requirement for judicial management that a company should be capable of recovery to the point where it is able to pay its full debt is outdated and makes it unrealistic.⁷⁰
4. The attitude of the court treating judicial management as a remedy that should be allowed in exceptional circumstances constitutes a challenge.⁷¹
5. The Act did not provide for statutory qualifications for judicial managers.⁷²
6. The fact that judicial management applies to companies only.⁷³
7. The insolvency requirement before commencing judicial management.⁷⁴

to regulate the affairs of Close Corporations still in existence subject to any limitation provided in Companies Act 2008.

⁶⁵ Section 72 (11).

⁶⁶ Boraine "Some thoughts on the reform of administration orders and related issues" 2003 (2) *De Jure*, 217-251.

⁶⁷ Pieter Kloppers "Judicial Management- A Corporate Rescue Mechanism in Need of Reform" (1999) *Stellenbosch LR* 417; Harry Rajak "Business Rescue for South Africa" (1999) 116 *SALJ* 262; DA Burdette "Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa" (2004) 16 *SA Merc LJ* Volume 1 & 2.

⁶⁸ *Ibid.*

⁶⁹ *Ibid*

⁷⁰ *Ibid*

⁷¹ *Ibid*; *Le Roux Hotel Management (Pty) Ltd V. Rand (Pty) Ltd* 2001 (2) SA 727 (CPD).

⁷² *Ibid.*

⁷³ *Ibid*

8. Judicial management places heavy reliance on court procedures.⁷⁵
9. No provision for automatic Moratorium.⁷⁶

In addition to the above, one disagrees with the idea of the Judicial Manager having the power to determine that judicial management will not be successful and on that basis apply for liquidation.⁷⁷ Indeed, the whole process of judicial management appeared to me more like a step to liquidation rather than a rescue provision. It may however not be necessary to go further on this issue having been replaced by a new law thankfully. On May 2011, the Companies Act 2008 came into force with a new business rescue, hopefully to address the challenges of judicial management or better still provide a more effective business rescue system.

3.2.2 Overview of the Companies Act 2008

The business rescue provision under the Companies Act 2008 is contained in sections 128 – 154. Section 128 is the definition chapter. By virtue of 129, directors of a company can pass a resolution for a voluntary business rescue proceedings and place the company under supervision if the board has reasonable ground to believe that the company is financially distressed and there appears to be a reasonable prospect of rescuing the company. Section 130 allows objection to company resolution in terms of section 129 by an affected person. Section 131 allows an affected person to apply to the court for an order placing the company under liquidation. Section 132 deals on duration of business rescue proceedings, 133 is the moratorium provision, 134 on protection of property interests, 135 on post-commencement finance. The effects of business rescue on employees, contracts, shareholders and directors are contained in sections 136-137. The qualification for practitioners is in terms of 138 who can be removed or replaced pursuant to 139. The powers, duties and investigatory role of the practitioner are provided under sections 140-141. The directors are expected to co-operate and assist the practitioner. The practitioner receives remuneration and in certain instances contingency fees as per section 143. Employees have the numerous rights listed in 144. Sections 145 and 146 allow participation by creditors and shareholders in the rescue proceedings. Within 10 days after appointment of practitioner, he must convene first meeting of creditors and first meeting of employees' representatives. In the event that creditors

⁷⁴ *Ibid*

⁷⁵ *Ibid.*

⁷⁶ *Ibid*; see also Section 428(2)(c) Companies Act 61 of 1973.

⁷⁷Section433(j) Companies Act 1973.

appoint a committee of creditors and the employees appoint employees' committee, the functions of the committee are as stated in 149. The practitioner after consultation with the creditors and other affected person must prepare a business plan in terms of section 150 for possible adoption at a meeting held pursuant to section 151. Section 153 is on failure to adopt business rescue plan while section 154 provides for discharge of debts and claims in terms of a creditor who has acceded to the discharge of the whole or part of his debt owing to that creditor will lose the right to enforce the relevant debt or part of it.

In summary, the various ways of initiating business rescue proceedings under this Act include the informal mean which is pursuant to Board resolutions and the court or formal procedure which is initiated by an affected person. Further, the court may during the course of liquidation proceedings or proceeding to enforce a security interest make an order placing a company under supervision.⁷⁸ Where business rescue is commenced pursuant to section 129, the company shall within five days after passing the resolution or such extended time appoint a business rescue practitioner. Where an application is made to the court, the court may appoint as interim practitioner subject to ramification as per the meeting under section 147. Once the practitioner is appointed, he has the duties to drive the business rescue process with the co-operations of the directors. He is expected to continue to liaise with the affected persons throughout the process and must consult with them in preparing a rescue plan.

3.2.3 Innovations

It seems that in formulating the new Act, some of the observations made by learned writers referred to in 3.2.1 above where taken into consideration. The efforts of the draftsmen are therefore appreciated and are highly commendable base on the following innovations:

3.2.3.1. The Act has introduced two major means of commencing business rescue namely: (a) the voluntary business rescue which presents an informal rescue mechanism that would be cheaper and faster for a company. (b) There is also an opportunity for an affected person to bring an application for business rescue.⁷⁹

3.2.3.2. A person who acted as practitioner with respect to a business rescue is disqualified from being appointed as liquidator in the event that the company is put under

⁷⁸ Section 131(7).

⁷⁹ Sections 129 and 131.

liquidation.⁸⁰ That way, the chances of a practitioner who acted for the business rescue instigating liquidation in an attempt to earn higher fee is reduced considerably.

3.2.3.3. There exists some form of qualification provision for business rescue practitioners.⁸¹

The current structure seeks to aim at competent practitioners undertaking business rescue unlike the judicial management procedure. In addition to the requirements in section 138, Regulations⁸² 127 and 128 have further classified persons eligible to practice into senior, experienced and junior practitioners depending on the years of practical experience. Form CoR 126.1⁸³ which is an application for practitioner's licence requires the applying practitioner to attach a resume of history and experience in business turnaround as well as relevant education.

3.2.3.4. During business rescue proceedings, no legal proceeding including enforcement action may be commenced except under circumstances listed in 133 (1) (a)-(f). The provision of moratorium which is now automatic is commendable.⁸⁴

3.2.3.5. The post commencement finance provision enables a company under business rescue to seek financial assistance where required to ensure the success of the proceedings. It should be noted however that the order of preference discussed below may not be encouraging to possible lenders.⁸⁵

3.2.3.6. The Act has provided additional remuneration for practitioners on contingency basis. This would encourage business rescue practitioners to aim at rescuing the business.⁸⁶

3.2.3.7. There is a provision for preparation and adoption of business plan.⁸⁷

3.2.3.8. Master's control as seen under judicial management is no longer applicable.

3.2.4 Challenges

Despite the above innovations of the Companies Act, one cannot help but observed certain loopholes which may pose challenges in future. Some of which are:

⁸⁰Section 140 (4).

⁸¹ Section 138.

⁸² Companies Regulations 2011

⁸³ <http://www.cipc.co.za>

⁸⁴ Section 133.

⁸⁵ Section 135.

⁸⁶ Section 143.

⁸⁷ Sections 150-154

- 3.2.4.1. To begin rescue proceedings in terms of 129 or 131; one of the requirements is that the company is financially distressed. Section 128 defines “financially distressed” to mean when it appears to be reasonably unlikely that the company would pay all its debts as they fall due and payable within the ensuing six months or it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months.
- 3.2.4.2. The rescue provisions apply to companies and close corporations only.⁸⁸ As the only business rescue provision in South Africa, there is no reason to limit the application to these two.⁸⁹ My view is that the Act should have extended further in schedule 3 to cover not only close corporations but other entities. This gap leaves one to suggest that there could still be need for a rescue provision that would apply to both companies and other entities.
- 3.2.4.3. In terms of Regulations 127, (a) a senior practitioner must have been actively engaged in business turnaround for a period of ten years, (b) an experienced practitioner for five years while (c) a junior practitioner may have no turnaround experience but would only be appointed as practitioner for a small company. My submission is that a small company also deserves the attention of a rescue practitioner with some form of experience or additional qualification in business turnaround. Further, one wonders if the ten years and five years business turnaround experience of senior and experienced practitioners would factor in their success stories. It will not be out of place to see practitioners of the old judicial management claiming years of experience as experts in business turnarounds even where judicial management has been recorded as massive failure.⁹⁰ In addition, it is not certain whether by virtue of Regulations 127, a liquidator can qualify as senior or experienced business rescue practitioner without showing the required business turnaround experience or perhaps such a liquidator would be treated as a junior practitioner with no experience in business turnaround. Whilst the Act in terms of 140(4) prohibits a person who has acted as rescue practitioner from acting as liquidator where the rescue proceeding is converted to liquidation, it is possible in terms of 136(4) for a company under liquidation to eventually end up in business rescue. A liquidator upon appointment

⁸⁸ By virtue of Item 6, Schedule 3, Chapter 6 of the Companies Act 2008 will apply to close corporations.

⁸⁹ David Burdette (Lecture on LBR UP 2011)

⁹⁰ See footnote 116

may discover that the company has prospects or is still viable and on that basis advice on the pursuit of rescue proceedings. It would take knowledge of business turnaround and the right mind-set in my view for a liquidator to observe the viability of a business and render the necessary assistance to save the company.

3.2.4.4. There is no mandatory requirement for provision of security by the rescue practitioner to secure the interests of the company. An Application may only be made by an affected person in terms of 130(c) requiring the practitioner to provide security. This ordinarily to my mind should be an advantage as it would relieve a company undergoing business rescue from the additional burden of paying premiums on the bond taken by the rescue practitioner. On the other hand, it reiterates the need for good selection criteria to ensure that companies are not exposed to high risk in the absence of compulsory requirement for security.⁹¹

3.2.4.5. Where the company obtains finance during business rescue,⁹² the interest of such creditors who took the risk of lending to a company under rescue proceedings is placed below the interest of employees whether such creditors are secured or not. This is for the simple reason that section 135 provides that remuneration or expenses relating to employment will have preferences over the claim of the creditors under section 135(2). The said provision will discourage creditors for lending to the company.⁹³

3.2.4.6. The rescue practitioner is not allowed to cancel contract of employment and the court is also constrained in view of section 136 (1). Consequently, the company may be tied to its employees even when there is need to cut down employees for the rescue process to succeed.⁹⁴ One appreciates the concern of the Act in ensuring safety of employment, but to be realistic, there are instances where it would be necessary to cut down on employees to achieve a successful rescue. A company that is already financial strained may find it difficult to carry the burden of excessive employees that may not be required at that point in time.

⁹¹ See recommendation in Chapter 5

⁹² 135(2).

⁹³ Section 136; Burdette (LBR) *Supra*, See also recommendation in Chapter 5.

⁹⁴ *Ibid.*

To my mind, it is more profitable to downsize and save the company or business. That way the company will continue to trade and may eventually increase its capacity in terms of employment than to allow the business sink with all the employees.

3.2.4.7. One agrees with the assertion that the employees' rights under the Act are excessive.⁹⁵ I am of the view that their active participation in business rescue as well as all associated rights therein may ruin the process. One wonders whether the Act is aimed at rescuing employees more than the business, bearing in mind that it is the business that keeps the employees and not vice versa.

3.2.5 Compromise under section 155

Companies Act 1973 made provisions for Compromise and Arrangement under section 311.⁹⁶ The process basically allows for a compromise or arrangement between a company and its creditors or any class of them or between a company and its members or any class of them. The first step would be an application to court for a court-ordered meeting and where the arrangement or compromise is agreed by the required majority, a further application is made to court for sanction. This procedure was seen as being complex requiring two court applications with specially arranged separate meetings.⁹⁷ Additional criticism is the fact that there was no provision for moratorium,⁹⁸ thus leaving such a company at the mercy of creditors.

In terms of the Companies Act 2008, there is a "Proposal for Scheme of Arrangement"⁹⁹ under Chapter 5 as part of "Fundamental Transactions, Takeovers and Offers," Compromise alone is grouped with business rescue under Chapter 6 but section 155(2) made reference to arrangement or compromise. One is not sure what weighed in the minds of the draftsmen in making the above separations. What is the difference between "Proposal for Scheme of Arrangement" under section 114 and the proposal for arrangement mention in section 155(2)? It seems however that by classification, the compromise or arrangement intended under 155(2) is a rescue mechanism while those under Chapter 5 cannot be construed as such. By virtue of section 155, court ordered meeting has been eliminated as only one application to court is provided for which is the application seeking to sanction the proposal. Even at that, the word "may" used in 155(7) signifies that application to court for sanction is not

⁹⁵Loubser LLD *Supra*

⁹⁶ Companies Act 61 of 1973.

⁹⁷Rajak *supra* 287.

⁹⁸*Ibid.*

⁹⁹Section 114

mandatory. Perhaps, it is now the nature of the proposal that would guide the company on whether or not to make an application for sanction.

Suffice to add that the elimination of at least one court application is a plus as the process would be much easier and less expensive for companies. It is however submitted that, the Scheme of Arrangement and other related issues under chapter 5 are all strategies of saving a business alongside with compromise. My further observation is that there is still no moratorium applicable in terms of section 155, thus the lacuna in section 311 is carried over to 155.

3.3 The Magistrate Court Act 100

3.3.1 Applicable provision

In terms of section 74 of the Act, a debtor unable to pay his debt may apply for an administration order provided the debt does not exceed R50 000.¹⁰¹ The court may upon consideration of his application make the order providing for the administration of his estate and payment of his debts in instalments or otherwise. Once the application is granted, the debtor is required to make certain regular payments to the administrator appointed in terms of section 74E. The administrator draws up the list of creditors and pays them from the amount received from the debtor.¹⁰²

There are obvious limitations in the above Act, in the first place, the maximum requirement of R50 000 makes the option unavailable to debtors who owes more than the maximum amount. Secondly, in terms of section 74R, the granting of administration order is not a bar to sequestration of the debtors' estate. This means that a debtor under such an administration order can still be sequestrated. In addition to above limitations, the administration order does not offer a debtor opportunity of discharge from his debt because the order lapses after the administration cost and creditors have been paid in full.¹⁰³

3.3.2 The Law Reform Initiative

As mentioned earlier, the South African Law Reform Commission commenced investigation of the insolvency law in 1987 which culminated in draft Bill of 2000. The Commission recommended amongst others for pre-liquidation composition in section 74X of the

¹⁰⁰ 32 of 1944.

¹⁰¹ Bertelsmann *supra* 3.

¹⁰² Sections 74G and 74 J; Nagel *supra* 401.

¹⁰³ Section 74 U; Bertelsmann *supra* 4.

Magistrate Court. The proposed new section is to enable composition between the debtor and creditors before sequestration which is binding on all creditors if accepted by majority. The proposal provides for conversion to sequestration if the offer of composition is not accepted.¹⁰⁴

Whilst the above initiatives of the South African Law Reform Commission is applauded, one is of the view that merely inserting a pre-liquidation composition in the Magistrate Court Act will not address the limitation in the existing laws which is inadequate rescue mechanisms for debtors of all kind. There is need for a wholistic view of the rescue provisions in South Africa.

It seems however that the South African Law Reform Commission recognises the inherent challenges with the section 74 of the Magistrate Court Act. In its media release on review of Administration Order (Project 127): Questionnaire on Abolition of Administration Order¹⁰⁵, it identified the allegations of abuses and problems of administration order as follows:

1. Administrators overcharge for remuneration and expenses
2. Unsuitable persons are appointed as Administrators
3. Administrators do not distribute funds regularly and do not account to creditors
4. Administration Orders are not regulated properly
5. Section 74 does not contain discharge or time period for repayment which tantamount to keeping the debtors in bondage for life.

The Law Reform Commission by the above media release invited comments on the recommendation for abolition of administration order if certain changes were made to the National Credits Act such as providing for delictual claims.

3.4 The NCA ¹⁰⁶

In terms of section 85 of the NCA, in any court proceedings in which a credit agreement is being considered, if it is alleged that the consumer under the credit agreement is over indebted, the court may either refer the matter to the debt counsellor to evaluate the consumer's circumstances and make recommendation to the court or declare the consumer

¹⁰⁴ South African Law Commission Project 63 *supra*

¹⁰⁵ <http://www.justice.gov.za/salrc/media.htm>. (accessed May 30 2011).

¹⁰⁶ National Credit Act 34 of 2005.

over indebted and make any order contemplated under section 87 to relieve the consumer's over indebtedness. The order contemplated under section 87 include declaring a credit agreement to be reckless and re arranging the consumers obligation in terms of 86 (7) (c) (ii).

In terms of section 86 of the NCA, a consumer may apply to the debt counsellor to be declared over indebted. Consequent upon the application, the debt counsellor will conduct an assessment and if he concludes that:

- a. The consumer is not over-indebted; the debt counsellor must reject the application even if he had concluded that the credit agreement was reckless
- b. The consumer is not over-indebted but is experiencing or likely to experience difficulty in satisfying all his obligations under the credit agreement in the timely manner. In which case, he can recommend that the consumer and the credit providers agree on a plan of debt re-arrangement.
- c. The Consumer is over-indebted, in which case he may issue a proposal recommending that the Magistrate Court make either or both of the orders under 86 (7) (c) (i) and (ii).¹⁰⁷
- d. The order under 86 (7) (c) (i) is to the effect that one or more of the credit agreements be declared reckless whilst the order under 86 (7) (c) (ii) contemplates re-arrangement of the consumer's obligations.

In summary, the provisions of NCA particularly sections 85-87 allows a consumer who is financially over-burdened to restructure his payment obligations through the debt review process. The plan of debt re-arrangement in terms of section 86 (7) (b) is usually drafted as a consent order and subsequent application is made to the Tribunal¹⁰⁸ for confirmation.¹⁰⁹

It seems however that over-indebted consumers are utilizing this medium of debt re-arrangement. This explains the increase in the number of applications for debt counselling as well as consent applications received by the Tribunal as shown from statistics. As at March 2010, it was reported that between 7000 and 8000 new applications for debt counselling were

¹⁰⁷Section 86 (7); Van Heerden & Coetzee "Perspectives on the termination of debt review in terms of section 86(10) of the *National Credit Act* 34 of 2005" PER / PELJ 2011(14)2; Scholtz JW *et al Guide to the National Credit Act* (LexisNexis Butterworths Durban 2008) par 11.

¹⁰⁸National Consumer Tribunal established pursuant to section 26 of the Act.

¹⁰⁹Section 86(8) (a) and section 138.

received per month reaching 161749 applications at the end of the financial year.¹¹⁰ The estimated number of active applications for debt counselling was 1000 000, after allowing for withdrawals, terminations, cancellations and applications in progress.¹¹¹ With respect to the Tribunal, comparative analysis of applications received by for 2007/2008 to 2009/2010 shows that 11 applications (comprising of 2 consent and 9 non-consent applications) were received in 2007/8, 26 applications in 2008/9 (comprising of 4 consent and 22 non-consent applications), 488 applications in 2009/10 (comprising of 454 consent and 34 non-consent) and 1 382 applications in 2010/11 (comprising of 1 358 consent and 24 non-consent).¹¹²

Despite the above seemingly success of the NCA on debt re-arrangement, it is important to add that the NCA is not without its challenges or limitations. In the first place, Part D which contains section 86 has limited application as it does not apply to juristic persons. In addition the NCA applies to credit agreements only and one agrees with Heerden and Borraine¹¹³, that there may be circumstances where some debts of the consumer would not constitute credit agreements. Further challenges facing the debt counselling process as identified by the Law Clinic¹¹⁴ as well as South African media include amongst others non-cooperation of credit providers, legal uncertainties regarding the interpretation of the NCA, consumers not cooperating, incompetent counsellors and consumers lack of knowledge on the objective of the debt review process

It should be added however that the fact that a debt obligation does not constitute a credit agreement does not necessarily mean that such creditors will be excluded in debt re-arrangement plan. Indeed, section 24 of the National Credit Regulations¹¹⁵ requires the consumer to disclose all debts. Such disclosure is necessary to enable the debt counsellor make a candid assessment of the financial position of the consumer. There is nothing preventing the debt counsellor from including all creditors whether constituting credit agreement or otherwise in its proposal for debt re-arrangement. In my view therefore, the major challenges in section 86 are the fact that the debt re-arrangement obligation runs for

¹¹⁰ The National Credit Regulator (NCR) 2010 Annual Report.

¹¹¹ *Ibid*

¹¹² NCT 2011 Annual Report. (This document can be accessed from <http://www.thenct.org.za>).

¹¹³ Heerden “The Interaction between the Debt Relief Measures in the National Credit Act of 2005 and the Aspect of Insolvency Law” (2009) (12) 3 PELJ (22) 14.

¹¹⁴ University of Pretoria Law Clinic research: *The debt counseling process: challenges to consumers and the credit industry in general* (2009) 43, 51; Roestoff, “The Debt Counseling Process-Closing the loopholes in the National Credit Act 34

of 2005 *PER* 2009 (12) 4-5

¹¹⁵ 2006.

years thereby becoming a life time payment for consumers and most times worsening their situations.¹¹⁶ There is no provision for discharge unlike rehabilitation under insolvency law that offers a fresh start to the consumer.¹¹⁷ Also the qualifications of debt counsellor as presently constituted are largely accountable for the shortage of competent debt counsellors. Apparently, section 86 is caught up with similar challenges with the Administration Order discussed above. In addition, certain Court decisions on the NCA and its relationship with insolvency have created some uncertainties on the debt review process.

In *Selvin Laban Naidoo V. ABSA Bank*,¹¹⁸ the Supreme Court of Appeal held that a credit provider need not comply with the procedure provided for in section 129(1)(a) of the National Credit Act before instituting sequestration proceedings against a debtor because such proceedings are not proceedings to enforce a credit agreement.

Section 129 laid down the procedure to be followed before debt enforcement. In particular 129 (b) provides that subject to subsection 130 (2), the credit provider may not commence any legal proceedings to enforce the agreement before complying with notices as contemplated under 86(10) and meeting any further requirements under section 130. One of the requirements under section 130 by virtue of subsection (3)(c) is to forbid a credit provider for enforcing or commencing proceedings while the matter is before a debt counsellor in terms of section 86.

The court in the above case was of the view that sections 130 (3) (a), 127 and 131 are applicable to those proceedings involving the surrender and attachment of goods under a credit agreement and further held that sequestration proceedings is not the kind of proceedings to which section 129 (1)(b) refers. Whilst one may not go into the meaning of the word “enforcement” and whether it includes insolvency proceedings, it is however important to note that the above decision has huge impact on the whole process of debt re-arrangement. Going by the above judgment which confirm that a credit provider need not comply with section 129 and by extension 130, it means a credit provider can bring an application for sequestration while debt review is pending before a debt counsellor. This in my view may not agree with the intent of section 86. Even if one is to concede that section 130 should be construed strictly under the heading which it appeared being “Debt Enforcement by repossession or judgement”, there seems to be other provisions of the Act that suggest that it

¹¹⁶Heerden *supra* 14

¹¹⁷*Ibid.*

¹¹⁸(2010)ZASCA 72.

was the intent of the legislature that sequestration and debt review should not run simultaneously. For instance, section 88 (3) provides that a credit provider who has received notice in terms of section 86(4) (b) (i) may not *exercise* or enforce by litigation or *other judicial process any right* or security under the credit agreement until the occurrence of the circumstances under (a) and (b). It follows that even if the argument that sequestration is not enforcement is correct; sequestration definitely constitutes an exercise of a right by means of a judicial process and as such is caught up section 88(3) above.

It seems therefore that there is more work to be done in terms of interpreting the provisions of the NCA as they relate to insolvency proceedings. Although, in practice debt review might influence the issue of advantage to creditors in the consideration of sequestration application¹¹⁹, one is of the view that there is need for legislative intervention clarifying the relationship with insolvency and debt review under the NCA. No doubt, judgements such as the *Selvin's* case above may create a situation where credit providers will begin to disregard the section 86 processes, in which case the whole essence of using section 86 as a debt relief measure to assist over indebted consumers will be defeated.

3.5 Conclusion

In view of the above challenges identified in the existing laws, it is recommended as follows:

3.5.1 Pre-liquidation or sequestration composition should be provided in the Insolvency Act. This would yield a more positive result because it will afford a debtor the option of statutory composition prior to sequestration, thus avoiding the rigours of sequestration and the associated limitations. That way, debtors would be more willing to explore such a process in order to avoid sequestration. Suffice to say that the South African Law Commission seems to agree with the provision of pre-sequestration composition.¹²⁰

3.5.2 It is submitted that to wait for a company to become insolvent within six months before commencing business rescue may achieve no positive result as such a company may almost be at an insolvent stage.¹²¹ It is recommended that the section be exceeded to 12

¹¹⁹ Boraine & Heerden “To sequestrate or not to Sequestrate in view of the National Credit Act 34 of 2005: A tale of two judgments (2010) *PER* 19

¹²⁰ South African Law Commission on “Review of the Law of Insolvency” Project 63 Report (2000) par. 124

¹²¹ Burdette (2010) LBR 802 UP University of Pretoria

months to allow a company that anticipates financial challenges prior to six months should commence rescue proceedings.¹²²

Further, the qualification criteria of rescue practitioners as contained in the Act re-emphasize the need for business turnaround courses/training for insolvency practitioners whether acting as rescue practitioner or liquidator particularly in view of the expectations of Chapter 6 of the Act. While the senior and experienced practitioners can undergo one or two months training, practitioners with no business turnaround experience should undergo at least six months training and possibly written examinations. The CIPC¹²³ seems to be nursing the idea of suitable qualifications for rescue practitioners which should be a Certified Turnaround Professional qualification to be offered by the Turnaround Management Association.¹²⁴

It is recommended that section 74 of the Magistrate Court Act should be restructured to address existing loopholes in the administration procedure.¹²⁵ Alternatively, National Credits Act should be amended to incorporate all aspects of section 74 of the Magistrate Court Act as envisaged by the South African Law Commission in which case, section 74 can be abolished. It is better to have one law on rescue measures or is efficient than having plethora of laws that are not only inconsistent but faced with serious challenges.

To achieve the objective of relieving over-indebted consumers and offering a means of fulfilling payment obligations outside insolvency system, sequestration application should not proceed until the conclusion of debt review at least with respect to debts regulated by the NCA.

¹²² See Recommendation in Chapter 5

¹²³ Companies and Intellectual Property Commission

¹²⁴ “Business rescue implementation and operational status in South Africa” [http://www.business – rescue.co.za/business-rescue/business-rescue-implementation-and-operational-status.php](http://www.business-rescue.co.za/business-rescue/business-rescue-implementation-and-operational-status.php)

¹²⁵ See Recommendation in Chapter 5.

CHAPTER 4

COMPARATIVE ANALYSIS

Introduction

It will be necessary to consider other jurisdictions and how they addressed some of the challenges confronting South African laws as seen in Chapter 3. The jurisdictions that are considered are the United States, United Kingdom and Australia.

I chose the United States because it is leading the way in modern rescue culture and so many other jurisdictions have tried to model their rescue provisions along the line of Chapter 11.¹²⁶ Any discussion on a modern rescue system may be incomplete without reference to Chapter 11 of the US Bankruptcy Code.

South Africa adopted the English system of precedents and it is common knowledge that English law influences South African Law particularly in areas such as Insolvency and Company laws.¹²⁷

Australia in 1961 enacted a regime called the official management which was similar to the South African Judicial Management. The official management was considered as a failure and this led to the promulgation of the Corporate Law Reform Act 1993. The 1993 Act repealed the legislation on official management and in its place created a new business rescue called administration.¹²⁸ It will be interesting to consider whether the administration process serves as a good replacement of official management more so where its provisions are similar to the new South African business rescue under Companies Act 2008.

It must be mentioned that the aim of this comparative analysis is not to suggest in anyway that South Africa must adopt a particular country's model. The idea is to show global trends with respect to rescue mechanisms; perhaps South African may learn certain lessons from this process that would be useful in further developing its current laws taking into consideration its own peculiarities.

¹²⁶ Rajak *supra* 263; Bertelsmann *supra* 4

¹²⁷ Boraine "Elements of South African Insolvency Law" (2011 UP ILL) 1.

¹²⁸ Rajak *supra* 263.

4.1 *The United States*

4.1.1 Chapter 11

Chapter 11 of the Code¹²⁹ provides for reorganisation under the bankruptcy law of the United States. This section affords the debtor the opportunity to reorganise its affairs and pay its debtors over time. In summary, chapter 11 entails filing a plan for consideration by creditors. The plan is subsequently subject to confirmation by the court.¹³⁰ The effect of confirmation by the court is that the plan becomes binding on the debtor, any entity issuing security under the plan, and any entity acquiring property under the plan, any creditor, equity security holders, or general partner in the debtor. A further effect is that the debtor is discharged from any debt that arose before the date of such confirmation.¹³¹ Where the debtor is an individual, the court grants a discharge after completion of all payments under the plan. The court may also grant a discharge prior to completion of payment under certain circumstances. For instance if the value as of the effective date of the plan, of the property actually distributed under the plan on account of each allowed unsecured claim is not less than the amount that would have been paid on such claim if the estate of the debtor had been liquidated under chapter 7.¹³²

Contrary to the rescue provisions under South African's Companies Act, a Chapter 11 rescue is available to every business whether corporate, sole proprietorship or individual.¹³³ Also in terms of Chapter 11, the appointment of a trustee or examiner under chapter 11 seems not to be mandatory, thus a small company can sometimes save the cost associated with payment of rescue practitioners/trustee. The Trustee where appointed may recommend conversion of a case not just to liquidation under chapter 7 but also to chapter 12 or 13.¹³⁴ This is different from the South African system that suggests liquidation as the next option once the rescue mechanism has failed. Further, under chapter 11, the debtor in possession operates the business and still has all the rights and powers to perform all functions and duties except the investigative duties of a trustee in sections 1106 (a)(2),(3) and (4).¹³⁵

¹²⁹ Bankruptcy Code of 1978.

¹³⁰ Sections 1121-1129.

¹³¹ Section 1141.

¹³² Section 1141 (5).

¹³³ Several sections under Chapter 11 made reference to where the debtor is an individual e.g. sections 1141 (5), 1115 of the Bankruptcy Code.

¹³⁴ 1106(5).

¹³⁵ Section 1107.

Under Chapter 11, the court will grant the order for cancellation of such agreements on certain grounds including the fact that the balance of equities clearly favours rejection of such an agreement. If during the period when the collective bargaining agreement is in effect and if it is essential to the continuation of the debtor's business, or in order to avoid irreparable damage to the estate, the court may authorise the trustee to implement interim changes in terms of wages, benefits or work rules.¹³⁶ My observation therefore that the Code is more concerned about the debtor's business and its possible continuation unlike the South African system that provides very stringent measures in terms of employment contracts. Also the excessive power of employees under the South African system is unknown in Chapter 11. In addition, the insolvency requirement before a debtor can explore rescue option as provided under section 128 (f) of the South African Companies Act seems not to be applicable under Chapter 11.

4.1.2 Chapter 13

A debtor (essentially an individual) who has a disposable income necessary to fund a Chapter 13 plan may file for reorganisation under Chapter 13. Under this Chapter, the debtor proposes a plan to pay his creditors over 3-5 year period. This Chapter has certain similarities with the debt re-arrangement under the NCA. The significant part of Chapter 13 is the fact that a debtor is entitled to a discharge where he had completed payment in terms of the plan and even prior to completion of such payment in certain circumstances for instance if the value as of the effective date of the plan, of the property actually distributed under the plan on account of each allowed unsecured claim is not less than the amount that would have been paid on such claim if the estate of the debtor had been liquidated under chapter 7.¹³⁷ This is contrary to the debt re arrangement under the NCA where the debtor's payment could run for his rest of his life and yet no discharge is applicable. A point to note however on Chapter 13 is that the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* have made it more difficult for individuals to file under Chapter 7 and instead require them to file under Chapter 13. The Act also requires a debtor prior to filing under Chapter 7 or 13 to have received briefing on credit counselling.¹³⁸

¹³⁶Section 1113.

¹³⁷Sections 1327-1328.

¹³⁸ 109(h) of BAPCPA.

4.2 *The United Kingdom*¹³⁹

4.2.1 UKIA¹⁴⁰

Part 1 of the Insolvency Act,¹⁴¹ provides for Company Voluntary Arrangements and Part 11 for Administration Orders.

Although Parts 1 and 11 of the *Insolvency Act of 1986* applies to companies, by virtue of sections 4 and 6 of the *Insolvent Partnerships Order of 1994*, Parts 1 and 11 of the Insolvency Act have been extended to apply to partnerships as well. In respect of individuals, Part VIII of the Act provides for Individual Voluntary Arrangement (IVA) which offers individuals a formal alternative to bankruptcy.

It is significant to note that under the UK Act, employees are not listed as one of the persons that can bring an application for administration order.¹⁴² This is unlike the South African system where employees are included in list of affected persons and as such can bring an application under section 131 to commence business rescue.

Furthermore, there are no stringent measures on employment issues as are applicable in South Africa. Specifically, section 14(1) (a) allows the administrator to do all such things as may be necessary for the management of the affairs, business and property of the company. In addition, active participation of employees in the rescue proceedings is not applicable under the UK system.

In terms of qualification of an Insolvency practitioner,¹⁴³ under the UK system, one must either be a member of a professional body recognised under section 391 of the Act being permitted to act by or under the rules of that body or hold authorisation by a competent authority under section 393. An authorisation under section 393 is granted if the applicant is a fit and proper person and meets the required standard as well as prescribed requirements with respect to education, practical training and experience.

¹³⁹ UK..

¹⁴⁰ The Insolvency Act 1986.

¹⁴¹ 1986.

¹⁴² Section 9 of the Act.

¹⁴³ See sections 390-393.

A point to note is that the Law Society in UK is one of the recognised professional bodies in terms of the *Insolvency Practitioners (Recognised Professional Bodies) Order*.¹⁴⁴ Its requirements for licensing insolvency practitioners includes amongst others admission as solicitor for a least five years, provision of detailed information on education, training and practical experiences.¹⁴⁵

4.2.2 Debt Relief Orders

In addition to the above, Chapter 4 of the *Tribunal Courts Enforcement Act*¹⁴⁶ introduced Debt Relief Orders (DRO). These orders are suitable for people with less than 15,000 pounds debt. They last for 12 months within which period creditors named in the order cannot take any action to recover money without the permission of the court. The debtor gets a discharge from debts that were included in the order or plan.¹⁴⁷

4.2.3 Administration Orders

County Court administration orders relating to individuals are also made under *County Court Act*.¹⁴⁸ Through this process, a court may make an administrative order in favour of a debtor against whom judgment has been entered. Upon grant of the order, the debtor makes regular payments to the court for the benefit of his creditors. To grant such an order, the total debts must not be more than 5,000 pounds and the debtor would need to have regular income to make repayments. Apparently, individuals who do not qualify for Administration Order still have the option of IVA under Part VIII.

4.3 Australia

4.4.1 The Corporations Act of 2001

Part 5.1 on Arrangement and Reconstruction allows a company to enter into an arrangement or compromise with its creditors or any class of them or members of any class of them. Indeed, scheme of arrangement seem to have been superseded by the voluntary administration process which does not require court's involvement and as such is quicker and cheaper.¹⁴⁹

¹⁴⁴ 1986; Fletcher *supra* 25; Law Society Gazette: "Insolvency Practitioners" Wednesday 28 October 1987. (accessed on September 20 2011) <http://www.lawgazette.co.uk/news/insolvency-practitioners>.

¹⁴⁵ Law Society Gazette *supra*

¹⁴⁶ 2007.

¹⁴⁷ Section 114

¹⁴⁸ 1984. Sections 112-117.

¹⁴⁹ Silkenat27.

Part 5.3A deals with corporate rehabilitation. It is important to add that this section has certain similarities with the South African business rescue in the Companies Act 2008.¹⁵⁰ Despite the said similarities, certain differences are quite notable for instance in Australia, voluntary administration process commences by appointment of an administrator and such appointment can be made by the following three persons : the corporation, liquidator or provisional liquidator and secured creditors.¹⁵¹ Obviously employees are not included in the list of persons to commence administration process. Further, there is no provision for court to make an order for an appointment of an administrator.¹⁵² More importantly, the Australian provisions create no special provisions relating to employees.¹⁵³ An Australian High Court has made it clear that a fundamental aspect of the administrators' task was to operate the company as he deems fit and that accordingly even where there were possible breaches of industrial legislations; it was not prepared to order that employees must be retained by the company during a voluntary administration.¹⁵⁴

It is noteworthy that in some of the above states for instance, the UK and Australia, the Receivership process is also in place. This process is essentially aimed at benefiting the secured creditor in whose favour the receiver is appointed as opposed to the general interest of the company and all creditors, hence the least emphasize on it.

¹⁵⁰ Anderson “Viewing The Proposed South African Business Rescue Provisions from An Australian Perspectives” (2008) *PER* 4.

¹⁵¹ *Ibid.* See also sections 436A-436C of the Act.

¹⁵² Anderson.

¹⁵³ *Ibid.*

¹⁵⁴ *Ibid*; *Patrick Stevedores Operations (No 2) v Maritime Union of Australia* 195 *CLR* 1; 27 *ACSR* 53; 572 *ALJR* 873; 79 *IR* 339; 153 *ALR* 643; [1998] *HCA* 30 where it was stated that it is for the administrator, in the exercise of the discretionary powers conferred by section 437A, to decide whether or not to carry on the company's business and the form in which it should be carried on during the administration.

CHAPTER 5

RECOMMENDATIONS AND CONCLUSION

5.1 Summary

5.1.1 South Africa

From the above research, it is apparent that rescue provisions appear in one form or the other in certain South African laws such as: Insolvency Act, Companies Act, NCA, and MCA. The Companies Act which provides for business rescue applies to companies and close corporations. Consequently, other entities not covered by this Act are left to scramble for rescue alternatives in the NCA or MCA depending on which is applicable to them. Besides the fact that there is no singular law on rescue provisions that is comprehensive enough to apply to all entities, the various existing laws are faced with some challenges that prevent them from becoming as effective as they ought to be. Some of the identified challenges are summarised as follows:

5.1.1.1 Composition in terms of Insolvency Act and Close Corporation Act is available after the sequestration or liquidation order, thus forcing the debtor through the rigours of sequestration. Besides composition, no other rescue provision is contained in the Insolvency Act.

5.1.1.2 On Companies Act 2008:

5.1.1.2.1 the near insolvency requirement which implies the commencement of business rescue at a time when the company is almost insolvent is a challenge to both the company and rescue practitioner in terms of achieving success.¹⁵⁵

5.1.1.2.2 the rescue provision applies to only companies and close corporations, thus excluding other forms of businesses.¹⁵⁶

5.1.1.2.3 there is need for additional qualification or training on business turnaround.

¹⁵⁵ Section 128.

¹⁵⁶ Item 6, Schedule 3.

5.1.1.2.4 the post commencement finance does not provide real incentive to creditors who would be inclined to lend money to a company experiencing financial difficulty.¹⁵⁷

5.1.1.2.5 Stringent requirements in relation to cancellation of employment contracts.¹⁵⁸

5.1.1.2.6 Excessive employees' participation in the rescue process.¹⁵⁹

5.1.1.3 In terms of the Magistrate Court Act, the Administration order is not regulated properly; there is no discharge or period of time for payment and it does not bar sequestration.¹⁶⁰

5.1.1.4 With respect to the NCA, there is also no discharge provision and no time period for payment, thus debt rearrangement obligation end up becoming a life time payment. The qualification of debt counsellors needs to be reviewed and some court decisions have not helped matters in protecting debtors undergoing debt rearrangement.¹⁶¹

5.1.2 Foreign Jurisdictions

Comparative analysis shows that the US Chapter 11 applies to every business whether corporate or sole proprietorship and individual¹⁶² and as such no categories of persons are excluded from utilizing same. Particularly on employment contracts, the court will allow for cancellation of such agreements on certain grounds including the fact that the balance of equities clearly favours rejection of such an agreement.

In terms of Chapter 13 which is similar to debt rearrangement under the NCA, the repayment plan is for a period of 3-5 years with additional benefit of the debtor getting a discharge where he had completed payment and even prior to completion of such payment in certain circumstances.

The *UK Insolvency Act 1986* contains rescue provisions applicable to companies, individuals and partnerships by virtue of Parts I, II and VIII of the Act as well as the *Insolvent*

¹⁵⁷ Section 135.

¹⁵⁸ Section 136.

¹⁵⁹ Sections 128-150.

¹⁶⁰ Section 74.

¹⁶¹ Section 86; *Naidoo v. Absa Bank (Supra)*.

¹⁶² Several sections under Chapter 11 made reference to where the debtor is an individual e.g. sections 1141 (5), 1115 of the Bankruptcy Code.

Partnerships Order of 1994. Significantly, employees are not listed as one of the persons that can bring an application for administration order.¹⁶³ Further, the UK has a well structured system for admitting Insolvency practitioners and such professional bodies are well regulated.

In addition to the above legislations, the UK has introduced Debt Relief Orders pursuant to Chapter 4 of the *Tribunal Courts Enforcement Act*¹⁶⁴ to apply to people with less than 15,000 pounds debt. The order is for a period of 12 months within which period creditors named in the order cannot take any action to recover money without the permission of the court. A point to note is that there is also a County Court administration orders in UK relating to individuals with total debts of not more than 5, 000 pounds under *County Court Act*.¹⁶⁵

Australia on the other hand has metamorphosed from the era of “official management” to “administration” which is considered more informal and efficient. More importantly, there are no special provisions relating to employees.¹⁶⁶

5.2 Recommendations

The recommendations below would assist in addressing some of the identified challenges:

5.2.1 MCA

5.2.1.1 There is need to harmonize the provisions of section 74 of the Magistrate Courts Act with those of the NCA. The NCA should incorporate all aspects of section 74 of the MCA in which case, there may not be further need for section 74 MCA. That way the NCR would regulate administration process as well as debt review in terms of the NCA. Alternatively, section 74 of the MCA should continue to exist. Administrators should undergo prescribed training and also be part of insolvency practitioners to be regulated by a certified body. Section 74R of the MCA should then be redrafted as follows:

74R ~~The granting of an order under section 74(1) shall be no bar to the sequestration of the debtor’s estate. During the existence of an administration order in terms of this section:~~

(1) No creditor specified in the order is allowed to bring a sequestration application against the debtor’s estate with

¹⁶³Section 9 of the Act.

¹⁶⁴ 2007.

¹⁶⁵ 1984. Sections 112-117.

¹⁶⁶*Ibid.*

respect to the debt covered in the order except with the permission of the court.

- (2) The court's permission as stipulated in (1) above may be granted in exceptional circumstances and on conditions that the court deems fit.

5.2.1.2 In view of the South African Law Reform Commission recommendation for section 74X on pre-liquidation composition,¹⁶⁷ a new section 74Y should be inserted as follows:

74Y A debtor in whose favour an administration order has been granted or whose pre-composition in terms of 74X has been accepted shall be discharged from the debts specified in the order:

- (1) After payments of the debts as contained in the order; and
- (2) Upon satisfaction of the court that he/she has received counselling on financial management.

5.2.1.3 It is recommended also that payments in terms of an administration order should be structured to last for a period of two years after which the discharge application recommended in 74Y above will apply. The Act should further provide for non-dischargeable debts after two years payment to include all secured debts.

5.2.2 Insolvency Act

The submission that a pre-liquidation composition may be more suitable in the Insolvency Act as against the Magistrate Court Act is acceptable.¹⁶⁸ To my mind a pre-liquidation composition in the Magistrate Court Act may be caught up with the R50, 000 maximum requirement and not be available for all creditors. It is therefore submitted that the offer of composition should be one of the factors to be taken into consideration in granting a final sequestration order under section 12 of the Act. Section 12 of the Insolvency Act should therefore be amended as follows:

¹⁶⁷ Chapter 3 above.

¹⁶⁸ University of Pretoria-Burdette "The Introduction of A Truly Unified Insolvency Act Ancillary Matters" <http://upetd.up.ac.za/thesis/submitted/etd-11192002-142456/unrestricted/06part4cchapter10.pdf>. (accessed October 20 2011)

- 12** (1) If at the hearing pursuant to the aforesaid rule *nisi* the court is satisfied that-
- (a) the petitioning creditor has established against the debtor a claim such as is mentioned in subsection (1) of section nine; and
 - (b) the debtor has committed an act of insolvency or is insolvent;
 - (c) there is reason to believe that it will be to the advantage of creditors of the debtor if his estate is sequestrated,
- it may sequester the estate of the debtor
- (2) If at such hearing-
- (a) the court is not so satisfied in terms of (1) above, or
 - (b) the debtor has made an offer of composition which the court reasonably believes would better serve the interest of creditors,

it shall dismiss the petition for the sequestration of the estate of the debtor and set aside the order of provisional sequestration or require further proof of the matters set forth in the petition and postpone the hearing for any reasonable period but not *sine die*.

5.2.3 The NCA

5.2.3.1 Section 88(3) should be amended as follows:

88(3) Subject to section 86(9) and (10), a credit provider who receives notice of court proceedings contemplated in section 83 or 85, or notice in terms of section 86(4)(b)(i), may not exercise or enforce by litigation, sequestration or other judicial process any right or security under that credit agreement until-

- (a) the consumer is in default under the credit agreement; and
- (b) one of the following has occurred:
 - (i) An event contemplated in subsection (1)(a) through (c); or

- (ii) The consumer defaults on any obligation in terms of a re-arrangement agreed between the consumer and the credit providers, or ordered by a court or the Tribunal

5.2.3.2 Similar amendments to the 5.2.1 recommendation should be inserted to address discharge of debtors after payment of re-arranged obligations or prior to full payment as the court may determine. Section 71 (1)-(4) should therefore be amended as follows:

71. (1) A consumer whose debts have been re-arranged in terms of Part D of this Chapter, may apply to a debt counsellor at any time for a clearance certificate relating to that debt re-arrangement the court for a discharge after payment of the re-arranged debts:

(2) A debt counsellor who receives an application in terms of subsection (1), must:

(a) investigate the circumstances of the debt re-arrangement; and

(b) either

(i) issue a clearance in the prescribed form if the consumer has fully satisfied all the obligations under every credit agreement that was subject to the debt re-arrangement order or agreement, in accordance with that order or agreement; or

(ii) refuse to issue a clearance certificate, in any other case. Upon application in terms of subsection 1 above, the court shall order the discharge of the consumer from the said debts upon satisfaction that:

(a) the consumer had undergone counselling in financial management

(b) the debtor has not received any similar discharge three years prior to filing of debt review in terms of this Act.

~~(3) If a debt counsellor refuses to issue a clearance certificate contemplated in subsection 2 (b)(i), the consumer may apply to the Tribunal to review that decision, and if the Tribunal is satisfied that the consumer is entitled to the certificate in terms of subsection 2 (b)(i), the Tribunal may order the debt counsellor to issue a clearance certificate to the consumer.~~

3A) A consumer can apply to the court for discharge prior to completing full payment of his/her debts where:

- (a) due to circumstances beyond the consumer's control and through no fault attributable to him, the consumer is unable to complete the re-arranged debts;
- (b) due to the circumstances of the consumer as at the time of the application for discharge, modifying re-arranged debts is no longer possible or feasible; and
- (c) It is in the interest of justice to grant such an order taking into consideration the circumstances of the consumer as at the time of the application for discharge.

(3B) the court in granting the application in (3A) must be satisfied that creditors have been paid at least the minimum they ought to have received in sequestration.

(3C) an application for discharge in terms of (1) and (3A) above shall be not granted on non-dischargeable debts as defined in this Act.

~~(4) A consumer to whom a clearance certificate is issued in terms of this section may file a copy of that certificate~~ an order of discharge has been granted in terms of (2) and (3) shall be entitled to file the court's order with the national register established in terms of 67 or any credit bureau.

~~(5) Upon receiving a copy of a clearance certificate~~ the court's order, a credit bureau or the national credit register, must expunge from its records-

- (a) the fact that the consumer was subject to the relevant debt re-arrangement order or agreement;
- (b) any information relating to any default by the consumer that may have-
 - (i) precipitated the debt re-arrangement; or
 - (ii) been considered in making the debt re-arrangement order or agreement; and
- (c) any record that a particular credit agreement was subject to the relevant debt re-arrangement order or agreement.

It is submitted that the Act should then specify the non-dischargeable debts in terms of (3C). It is further submitted that debts like mortgage, certain tax obligations and perhaps secured credits should be non-dischargeable until fully paid.

5.2.3.3 In addition, section 86 (8) should also be amended as follows:

86(8) If a debt counsellor makes recommendation in terms of subsection (7)

(b) and-

(a) the consumer and each credit provider concerned accept that proposal, the debt counsellor must record the proposal in the form of an order, and if it is consented to by the consumer and each credit provider concerned, file it as a consent order in terms of section 138. Provided that no repayment plan as contemplated in section 86 shall be made to last for a period of more than five years.

The above amendment would ensure that dischargeable re-arranged debts do not run for a life time. More so when restrictions on incurring further debts are placed on consumer whilst under debt review.¹⁶⁹

5.2.3.4 With respect to the educational qualification and experience for debt counsellors, it has been recommended that the 2 years working experience be increased to five years and that such working experience should not to apply

¹⁶⁹ Section 88 of the NCA

to person(s) with tertiary qualification in either the field of law or economics and management science.¹⁷⁰ While the above recommendation is acceptable, it should be added that even persons having tertiary qualifications should not be excluded from acquiring practical experience or training on the NCA procedures. It is submitted that a person qualifying in terms of 10(a) should have requisite five years' experience while tertiary qualification holder in the field of law or economic and management science should also have some form of practical experience in any of the fields stipulated under (aa) to (ee) or at least undergo three months training in consumer protection courses as well as the debt counselling procedure and its intricacies. This recommendation is aimed at ensuring that the debt review process is undertaken by capable persons who can deliver results to consumers. Suffice to add that my interviewed with a South African liquidator¹⁷¹ revealed that most applications received for voluntary sequestration were failed debt reviews.

5.2.4. Companies Act

With regards to the Companies Act 2008, it is recommended as follows:

5.2.4.1 A holistic approach should be considered on rescue provisions such that they can apply not only to companies and close corporations but also to other business entities such as partnership, sole proprietorship, trust. The approach of Chapter 11 of the US is commendable as it applies to businesses and individuals. UK has extended its Part 1 and 11 to partnership in addition to Part V111 that applies to individuals. Prior to the promulgation of the Unified Insolvency Act which ideally should incorporate all aspects of rescue mechanisms, a temporary measure would be to extend this current rescue provisions to other entities in the same manner as item 6, Schedule 3 of the Act.

5.2.4.2. UNCITRAL considered parties who may apply for reorganisation and essentially the approach favours debtors and creditors subject to commencement standards.¹⁷²

¹⁷⁰ Roestoff *supra* 3.1

¹⁷¹ Zaheer Cassim is the Director of Cassim Inc .

¹⁷² UNCITRAL Legislative Guide on Insolvency Law (2004) 53-56, paras 45-53; 64-65, para 14.

The concept of including employees in the list of affected persons with rights to initiate business rescue, form committee and make representation on rescue plan pursuant to the Act should be reconsidered. My view is that as much as employment should be safeguarded, the interest of the company as well as its creditors should also be taken into consideration to strike a balance. The provisions on employee issues as presently constituted in the Act will give rise to instances of employees flooding the court at the slightest fear on account of initiating business rescue. Judging from the 2010 Industrial Action Report which recorded approximately 20 674 737 lost from about 74 work stoppages,¹⁷³ it is apparent that Labour Unions or employees are very active in protecting their rights. One can already anticipate the chaos that would surround business rescue in future in view of the powers given to employee in the Act. Although, frivolous applications would be thrown out by the court by virtue of the commencement standards set by the Act, initiating the process in the first instance may send wrong signal to the outside world particularly the creditors. For a public company, such wrong signal would impact negatively on its shares. It is therefore submitted that the right of employees to commence business rescue as contained in the Act should be further reconsidered in the light of the above. Perhaps in the interest of achieving the objectives of business rescue, employees should be excluded from categories of persons that could initiate business rescue.

Another significant point is the fact that the employees of Companies and Close Corporations have been accorded special privileges by virtue of the fact that the Act applies to Companies and Close Corporations only. Whilst those employees enjoy their privileges under business rescue, other employees are left to explore their options perhaps under the Labour Relations Act¹⁷⁴ and this to my mind may be considered discriminatory. It is submitted that Labour Law should be allowed to regulate the rights of employees, that way all employees would enjoy the similar privileges.

5.2.4.3 It was noted that a higher price may be obtained if the insolvency representative is able to terminate onerous labour contracts to achieve

¹⁷³ Annual Industrial Report 2010 published by the Department of Labour.

¹⁷⁴ 2002.

necessary reduction of the labour force of the debtor but however, the relationship between employee and employer raises some of the most difficult questions in insolvency law and it is not simply the contract itself which in essence is a pending contract like any other contract, but also the usually mandatory provisions of other laws that protect the position of employees.¹⁷⁵ The above reason developed the need for special regimes to deal with employees' rights during insolvency or business rescue. The South Africa regime in my view is quite stringent as the court cannot cancel employment contract except as contemplated in subsection 136 (1) which envisage any change to employment to be subject to labour laws. Whilst one agree that the rescue practitioner should not unilaterally cancel employment contract, there is need for some flexibility. It is therefore submitted that the Act be amended to empower the court to cancel employment contracts in instances where the company will suffer irreparably in carrying onerous labour contracts or where the balance of equities favour rejection of such contracts. This can be achieved by amending section 136 (2A) as follows:

(2A) when acting in terms of subsection (2)-

- (a) a business rescue practitioner must not suspend any provision of-
 - (i) an employment contract except with the leave of court and on satisfaction of the court that the balance of equities favour such cancellation; or
 - (ii) an agreement to which section 35A or 35B of the Insolvency Act, 1936 (Act 24 of 1936), would have applied had the company been liquidated.
- (b) a court may not cancel any provision of-
 - (i) an employment contract, except as contemplated in subsection (1) or where allowing such contracts would occasion irreparable damages to the company and the balance of equities favour the cancellation of the contracts; or

¹⁷⁵ 130, para 145.

- (ii) an agreement to which section 35A or 35B of the Insolvency Act, 1936 (Act 24 of 1936), would have applied had the company been liquidated; and
- (c) if a business practitioner suspends a provision of an agreement relating to security granted to the company, that provision nevertheless continues to apply for the purpose of section 134, with respect to any proposed disposal of property by the company.

5.2.4.4 The complexity of many insolvency proceedings makes it highly desirable for insolvency representative to be appropriately qualified with knowledge of law (not only of insolvency law, but also relevant commercial, finance and business law) as well as adequate experience in commercial and financial matters including accounting.¹⁷⁶ One therefore agrees with the idea of having rescue practitioners acquire Certified Turnaround Professional qualification.¹⁷⁷ It is however submitted that the senior and experienced practitioners should in addition to working experience undergo one or two months training in business turnaround as envisaged under Chapter 6 of the Act while practitioners with no business turnaround experience should undergo at least six months training and possibly written examinations. The fact that some of these professionals have liquidation background reiterates the need for further training on this process in order to produce professionals with the right mind-sets. Alternatively, the few Insolvency Practitioners Associations in South Africa should be certified to undertake a comprehensive training program on business rescue and liquidation for insolvency practitioners comprising of rescue practitioners, liquidators and administrators. That way, an insolvency practitioner who has gone through the certified training would have the requisite knowledge and skill to act as an administrator, rescue practitioner or liquidator. This will also ensure

¹⁷⁶ UNCITRAL 174-175, paras 35-41; 188, para 115..

¹⁷⁷ “Business rescue implementation and operational status in South Africa” <http://www.business-rescue.co.za/business-rescue/business-rescue-implementation-and-operational-status.php>

informality in the way and manner insolvency practitioners discharge their duties.

5.2.4.5. Section 135 on post-commencement finance may be discouraging to creditors who are willing to fund a company undergoing business rescue. Such creditors ought to enjoy certain priorities. , It is recommended that post commencement claims should enjoy preference as an administrative cost and be treated under Section 135 (3). Consequently section 135 (3) (b) should be deleted and 135 (2) (3) amended as follows:

- (2) During its business rescue proceedings, the company may obtain financing other than as contemplated in subsection (1), and any such financing-
 - (a) may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise encumbered; and
 - (b) will be paid ~~in the order of preference set out in subsection (3)(b) as contemplated under subsection (3) as cost of business rescue proceedings.~~
- (3) After payment of the practitioner's remuneration and expenses referred to in section 143, and other claims arising out of costs of the business rescue proceedings, all claims contemplated-
 - (a) In subsection (1) will be treated equally, but will-
 - (i) not have preference over claims contemplated in subsection 2, irrespective of whether or not they are secured
 - (ii) have preference over all unsecured claims against the company except unsecured claims in terms of subsection (2) above; or
 - (b) in subsection (2) will have preference in the order in which they were incurred over all other unsecured claims against the company as well as the subsection (1) claims.

5.2.4.6. It is submitted that business rescue proceedings should be pursued as early as possible and not just upon realisation of a business becoming insolvent within the ensuing six months. That way, the likelihood of success is increased. A company's yearly income statement and balance sheet are useful materials in evaluating the financial position of the company. Consequently, a period of 12 months being the full cycle of a company is hereby recommended. Section 128 (f) should then be amended as follows:

'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 become due and payable within the immediate ensuing ~~six~~ twelve months; or
- (ii) it appears to be reasonably likely that the company will become insolvent within the immediate ensuing ~~six~~ twelve months.

CONCLUSION

South Africa's efforts are greatly applauded, especially on the new business rescue and indeed, it appears to be leading the way in Africa. Nigeria's Companies Act¹⁷⁸ for instance only provides for Scheme of Arrangement, Receivership and Management. Having said that, what is worth doing is worth doing well. This is more so, bearing in mind the likely possibilities of other African countries considering the South African provisions when initiating rescue reforms. Any mistake therefore could have domino effects, hence the need to address all apparent loopholes to ensure not only good precedents for other African countries but also effective rescue mechanisms beneficial to corporate and non-corporate entities in South Africa. It is believed that the implementation of the above recommendations will not only tie the loose ends but will harmonize South African Laws and ensure the availability of effective rescue mechanisms for both and non-corporate entities.

¹⁷⁸ Companies and Allied Matters Act LFN 2004.

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