

## **PART 3**

### **CORPORATE INSOLVENCY LAW REFORM IN OTHER JURISDICTIONS**

#### **CHAPTER 4: INSOLVENCY LAW REFORM IN ENGLAND, AUSTRALIA, GERMANY AND THE UNITED STATES OF AMERICA . . . . 77**

In this part a brief comparative study will be made of insolvency law reform in certain selected jurisdictions. The jurisdictions have been selected on the basis of similarity to South African legislation (England), innovations regarding unified legislation (United States of America), the decision not to unify insolvency legislation (Australia) and the successful introduction of unified legislation (Germany). This examination is necessary as the lessons already learnt by other jurisdictions will be of great value in determining not only whether a unified insolvency statute in South Africa is achievable, but also whether it is desirable.

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## CHAPTER 4

### INSOLVENCY LAW REFORM IN ENGLAND, AUSTRALIA, GERMANY AND THE UNITED STATES OF AMERICA

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#### 1 INTRODUCTION

In determining whether it is attainable, or even desirable, to bring about a unified insolvency statute in South Africa, reference to other jurisdictions may be a useful benchmark. Countries such as Germany and the United States of America have by all accounts succeeded in bringing about unified insolvency legislation. In referring to these two jurisdictions one has to look especially at their codified system of legislation and the fact that they have specialist insolvency or bankruptcy courts. Reference will also be made to the insolvency systems of England and Australia, both of which have similar legislation to that employed in South Africa.<sup>1</sup>

This chapter is not intended to give a detailed exposition of German, American, English or Australian insolvency law. Rather it is intended to refer to these jurisdictions in respect of the historical development of their insolvency laws, the reform process they have followed, and the philosophy underlying their respective systems. Due to the fact that South African insolvency legislation has been modelled on English law, the law reform process in this country will be

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<sup>1</sup> This is because both South Africa and Australia “inherited” their insolvency legislation from England - see the discussion of this aspect in ch 3 above.

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discussed in more detail than the other systems referred to. It will also be important to note how Australia, who also obtained their insolvency laws from England, have since approached the subject in their own reform process.

## 2 ENGLAND

### 2 1 Introduction and historical background<sup>2</sup>

The development of English insolvency law<sup>3</sup> generally, but winding-up law more specifically, is important for the purposes of this study. This is due to the fact that, as shown in Chapter 3 above, South African insolvency and company law legislation is deeply rooted in English law. Also, the development of English insolvency and winding-up law during the twentieth century was extensive and many changes were introduced. In this regard the so-called Cork Report<sup>4</sup> is of special importance, since it brought about the single most important change to insolvency and winding-up law in England in the twentieth century.<sup>5</sup> Although one of the main aims of the Cork

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<sup>2</sup> For a detailed discussion of the history of English insolvency law, see generally Dalhuisen *Dalhuisen on International Insolvency and Bankruptcy* (1986) paras 2.02[8], 3.08 (hereinafter referred to as Dalhuisen); Fletcher *The Law of Insolvency* 2nd ed (1996) 6-21 (hereinafter referred to as Fletcher); Levinthal "The Early History of Bankruptcy Law" 1918 66 *University of Pennsylvania Law Review* 223-250. For an interesting look at the early history of bankruptcy, see also Dal Pont and Griggs "The Journey from Ear-cropping and Capital Punishment to the Bankruptcy Legislation Amendment Bill 1995" 1988 8 *Corporate and Business Law Journal* 155.

<sup>3</sup> Although the terms "insolvency" and "bankruptcy" are used interchangeably throughout this study, it is important to point out the origin of these two terms. Fletcher 4 points out that the distinction between the two terms arose as a result of the uncoordinated development of the rules relating to debt and bankruptcy. Fletcher then distinguishes between the two terms by stating that "insolvency" was used to describe a factual position (ie liabilities exceeding the assets) while "bankruptcy" was used to describe a legal condition or status. For a discussion of the distinction between these two terms, see Fletcher 4-6; Milman and Durrant *Corporate Insolvency Law and Practice* 3rd ed (1999) 2 (hereinafter referred to as Milman and Durrant).

<sup>4</sup> *Insolvency Law and Practice, Report of the Review Committee* (Cmnd 8558) 1982 (hereinafter referred to as the Cork Report).

<sup>5</sup> Fletcher 13-20.

Report was to bring about a truly unified Insolvency Act in England, this did not take place to the extent envisaged by the review committee itself.<sup>6</sup>

Fletcher<sup>7</sup> states that one of the main characteristics of English insolvency law is that it maintains a number of fundamental distinctions between the insolvency of individuals and the insolvency of juristic persons. He further states that this division “is largely the result of the accidents of legal development”, and that it remains of continuing importance in spite of the attempts made in recent years to consolidate the disparate elements of English insolvency law.<sup>8</sup>

As was the case in most other jurisdictions,<sup>9</sup> the early history of insolvency law in England<sup>10</sup> dealt only with the insolvency of individuals.<sup>11</sup> The earliest statutes dealing with the insolvency of individuals were enacted from time to time from the mid-sixteenth century onwards.<sup>12</sup> The founding statute appears to have been Statute 1542,<sup>13</sup> although reference is also made to an earlier statute, namely Statute 1376.<sup>14</sup> In England the statutes dealing with insolvency did not originally deal with insolvency, as this was regulated by the Law Merchant which was a distinct body of law

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<sup>6</sup> See Keay “To Unify or Not to Unify Insolvency Legislation: International Experience and the Latest South African Proposals” 1999 1 *DJ* 65-68 (hereinafter referred to as Keay “To Unify or not to Unify”); Fletcher 18-19.

<sup>7</sup> Fletcher 6.

<sup>8</sup> Fletcher 6.

<sup>9</sup> For a detailed discussion and exposition of the historical development of the various jurisdictions, see Dalhuisen Vol 1.

<sup>10</sup> For a more detailed exposition of early English insolvency law see Dalhuisen par 2.02[8] 1-39-1-44; Mussman and Riesenfeld “Garnishment and Bankruptcy” 1942 27 *Minnesota Law Review* 1; Riesenfeld “Collection of Money Judgments in American Law: A Historical Inventory and Prospectus” 1957 42 *Iowa Law Review* 155; Riesenfeld “Enforcement of Money Judgments in Early American History” 1973 71 *Michigan Law Review* 691.

<sup>11</sup> Fletcher 6.

<sup>12</sup> Fletcher 6.

<sup>13</sup> 34 and 35 Hen 8 c 6.

<sup>14</sup> 50 Ed 3 c 6. See also Fletcher 6.

developed by a network of courts that were spread across Europe during medieval times.<sup>15</sup> These medieval courts exercised special jurisdiction over the transactions of merchants and matters relating to commerce, even though they were based within different, sovereign territories.<sup>16</sup> Although the Law Merchant drew extensively from the customs and practices that had become established among merchants in their dealings with each other, it was principally based upon Italian mercantile law,<sup>17</sup> which was itself derived from Roman law.<sup>18</sup>

The Law Merchant procedures for cases of individual insolvency were adapted from the Roman law procedures of *cessio bonorum*, *distractio bonorum*, *remissio* and *dilatio*.<sup>19</sup> Even though these procedures were absorbed into the Law Merchant, they enjoyed only a limited influence upon the general law of England, and were mainly confined in their application to the ranks of the merchants themselves.<sup>20</sup> However, the centralised jurisdiction of the ordinary Common Law courts gradually superseded the jurisdiction of the Merchant and Maritime Courts from the fourteenth century onwards.<sup>21</sup> During this process a considerable part of the Law Merchant was absorbed into English common law, and by the end of the seventeenth century the courts regularly took judicial notice of mercantile custom.<sup>22</sup>

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<sup>15</sup> Fletcher 6.

<sup>16</sup> Fletcher 6.

<sup>17</sup> For the position in Italy at this time, see Dalhuisen par 2.02[1] 1-24–1-26.

<sup>18</sup> Fletcher 6; Dalhuisen Vol 1 part 1 ch 2.

<sup>19</sup> Fletcher 6; Dalhuisen Vol part 1 para 1.01-1.05.

<sup>20</sup> Fletcher 7.

<sup>21</sup> Fletcher 7.

<sup>22</sup> Fletcher 7.

In 1542 the first English Bankruptcy Act was promulgated and dealt mainly with absconding debtors.<sup>23</sup> Fletcher<sup>24</sup> points out that two important principles of insolvency law had already crystallised at this time, namely the collective nature of bankruptcy proceedings and the *pari passu* principle of equal distribution amongst creditors. 1571 saw the promulgation of two further statutes, the first<sup>25</sup> dealing with the setting aside of fraudulent conveyances and the second<sup>26</sup> setting out detailed provisions for dealing with insolvent debtors.<sup>27</sup> Initially these statutory enactments only applied to insolvent traders, clearly showing the historic roots of the Law Merchant.<sup>28</sup> However, in 1861 the Bankruptcy Act of that year declared its provisions to be applicable to all debtors, not only insolvent traders.<sup>29</sup>

The distinction between traders and non-traders prior to 1861 had dire consequences for insolvent non-trader debtors, as they were subjected to the common law procedures for the enforcement of the payment of debts through the seizure and imprisonment of the debtor and the seizure and sale of the person's assets.<sup>30</sup> During this period there were also no provisions relating to a discharge of the debtor from his debt, although a statute introduced in 1705<sup>31</sup> did make some provision for a discharge.<sup>32</sup> The law was also very harsh at this time, not making any distinction between an honest and a dishonest debtor.<sup>33</sup> A series of bankruptcy statutes promulgated during

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<sup>23</sup> Statute 1542 34 and 35 Hen 8 c 4; Fletcher 7; Dalhuisen par 2.02[8] 1-41-1-42.

<sup>24</sup> Fletcher 7.

<sup>25</sup> The Fraudulent Conveyances Act 1571 13 Eliz 1 c 5 - see Fletcher 7.

<sup>26</sup> The Bankrupts Act 1571 13 Eliz 1 c 7 - see Fletcher 7.

<sup>27</sup> See also Dalhuisen par 2.02[8] 1-42.

<sup>28</sup> Fletcher 8.

<sup>29</sup> Fletcher 8; Dalhuisen par 2.02[8] 1-43.

<sup>30</sup> Fletcher 8.

<sup>31</sup> 4 & 5 Anne c 4.

<sup>32</sup> Fletcher 9.

<sup>33</sup> Fletcher 9.

the nineteenth century laid the foundation of modern English bankruptcy law. The plight of non-trader debtors was first addressed by the establishment, in 1813, of a Court for the Relief of Insolvent Debtors.<sup>34</sup> Other reforms to the law of bankruptcy were brought about by the Bankruptcy Act 1824<sup>35</sup> and were consolidated in the Bankruptcy Act 1825.<sup>36</sup> The Bankruptcy Act 1883<sup>37</sup> eventually saw a stage where insolvency law took on a form that is still recognisable in English law today.<sup>38</sup>

The traditional distinction between individual and corporate insolvency under English law is still discernable today, although some development did take place which has narrowed the divide.<sup>39</sup> The reason for this separate development<sup>40</sup> is the relatively recent concept of corporate legal personality, which only started to develop properly from the mid-nineteenth century.<sup>41</sup> The possibility of limiting one's personal liability was the cause of the distinction between corporate and individual insolvency, and was authoritatively confirmed by the House of Lords in the well-known case of *Salomon v Salomon & Co.*<sup>42</sup> In essence the unsecured creditors of a company, of which Salomon was the sole shareholder, wanted to hold Salomon personally liable for the company's debts when it was placed under liquidation. It was held by the House of Lords that

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<sup>34</sup> 53 Geo 3 c 102 and c 138 (Ireland), amended by 54 Geo 3 c 23 and c 28. See Fletcher 9.

<sup>35</sup> 5 Geo 4 c 98.

<sup>36</sup> 6 Geo 4 c 16. See also Dalhuisen par 3.08[1] 1-86.

<sup>37</sup> Fletcher 10.

<sup>38</sup> Dalhuisen par 3.08[2] 1-88.

<sup>39</sup> See Fletcher 10-13.

<sup>40</sup> The development of corporate insolvency law in England is discussed in detail in ch 3 above, and will for this reason not be repeated here. In this section merely a shortened version of the historical development will be provided.

<sup>41</sup> Fletcher 10.

<sup>42</sup> [1897] AC 22.

upon formation of a company it becomes a distinct person in law that is separate from its shareholders. Consequently the company's debts are separate and self-contained, and are not those of the individual members of the company.

From 1844 onwards,<sup>43</sup> due to the first Companies Act that had been promulgated, corporate insolvency was regulated by special statutory provisions.<sup>44</sup> These provisions were consolidated into the various versions of the Companies Act until, finally, in 1985 and 1986 they were moved out of the Companies Act and into the (English) Insolvency Act 1985 and 1986.<sup>45</sup> In early winding-up law the concept of limited liability had not yet taken proper shape, and consequently the legislation sought to treat insolvent companies as a species of bankrupt.<sup>46</sup> The concept of limited liability only became properly established under English law with the promulgation of the Limited Liability Act 1855.<sup>47</sup> Bankruptcy proceedings in England became rather confusing when the Winding Up Amending Act 1848<sup>48</sup> made provision for a procedure whereby shareholders of a company could bring about its dissolution and winding-up by presenting a petition to the Chancery Court, a procedure that was used in parallel to the procedure used by creditors in the Bankruptcy Court.<sup>49</sup> As a result of the conflicting jurisdiction of the courts, all the procedures were eventually consolidated in 1862,<sup>50</sup> giving the Chancery Court exclusive jurisdiction regarding corporate insolvency.

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<sup>43</sup> See also Dalhuisen par 3.08[2] 1-87.

<sup>44</sup> Fletcher 11.

<sup>45</sup> Fletcher 11; Dalhuisen par 3.08[2] 1-87.

<sup>46</sup> Fletcher 11.

<sup>47</sup> Fletcher 11.

<sup>48</sup> 11 & 12 Vict c 45.

<sup>49</sup> Fletcher 12.

<sup>50</sup> Companies Act 1862 (25 & 26 Vict c 89) s 81. See Fletcher 12.

This provided further impetus to the development of specialised procedures for corporate insolvency, which were initially contained within the provisions of successive Companies Acts as from 1856.<sup>51</sup> These specialised provisions resulted in company winding-up developing along its own particular lines, separate from the basic framework and substance of the law regulating the insolvency of individuals.<sup>52</sup> The net result of these developments was that by the late nineteenth century corporate and individual insolvency had developed into two distinct branches of the law, each of which were governed by different courts and different sets of procedural rules.<sup>53</sup> Although there were many similarities between the two systems, there was still a substantial divergence between these two types of insolvency.<sup>54</sup> This divergence is still evident in modern English insolvency law, even though the procedures have since been consolidated into a single Act, namely the (English) Insolvency Act 1986.<sup>55</sup>

## 2 2 Insolvency law reform and the Cork Report

In England the historical divisions between corporate and individual insolvency continued well into the twentieth century, and was reflected in the approaches taken by the review and reform of these branches of insolvency law.<sup>56</sup> Various committees<sup>57</sup> were formed over the years whose main task was to review certain aspects of law that pertained to insolvency and company law.<sup>58</sup>

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<sup>51</sup> This process was commenced in the Companies Act 1856 (19 & 20 Vict c 47) part 3, ss 59-105.

<sup>52</sup> Fletcher 12.

<sup>53</sup> Fletcher 12.

<sup>54</sup> Fletcher 12. This is also what South Africa inherited from England.

<sup>55</sup> Fletcher 12-13. See also Milman and Durrant 2 where this distinction is emphasised.

<sup>56</sup> Fletcher 13.

<sup>57</sup> The committees that were formed to look into aspects of individual insolvency law were the Muir Mackenzie Committee (1906 Cd 4068); the Hansell Committee (Cmnd 2326 1925); and the Blagden Committee (Cmnd 221 1957). Committees appointed to review company law included the Loreburn Committee (Cd 3052 1906); the Greene Committee (Cmnd 2657 1926); the Cohen Committee (Cmnd 6659 1945); and the Jenkins Committee (Cmnd 1749 1959). See also Fletcher 13 fn 39.

<sup>58</sup> Fletcher 13.

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However, the first comprehensive review of the law of insolvency was only undertaken in 1977,<sup>59</sup> under the chairmanship of Sir Kenneth Cork. The Cork Committee was given a very wide brief:<sup>60</sup>

- (a) To undertake a total review of the law of insolvency, bankruptcy, liquidation and receiverships, and to consider reforms that are necessary or desirable;
- (b) To examine the possibility of formulating a comprehensive insolvency system, including the possibility of harmonising and integrating procedures;
- (c) To investigate the possibility of formulating less formal procedures as alternatives to bankruptcy and winding-up; and
- (d) To make recommendations.

Despite the epoch-making report of the Cork Committee<sup>61</sup> in which various recommendations were made regarding all aspects of insolvency law and procedure, the Cork Report did not include a draft Bill.<sup>62</sup> The change of government in England in May 1979 had a negative impact on the work being done by the Cork Committee,<sup>63</sup> and due to a request from the government the Cork Committee had no option but to lodge an interim report in October 1979.<sup>64</sup> The final report of the Cork Committee was eventually submitted in 1982, making out a vigorous case for fundamental reforms regarding the law of insolvency.<sup>65</sup> Unfortunately not all the recommendations made in the

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<sup>59</sup> For a discussion of the events that led to the appointment of the Cork Committee, see Fletcher 14-15.

<sup>60</sup> Fletcher 15.

<sup>61</sup> See also the remarks regarding the Cork Report in Dalhuisen par 3.08[4] 1-93.

<sup>62</sup> This was in contradistinction to law reform that was taking place in Scotland at the same time - see *Report of the Scottish Law Commission* (published in 1982 as HC Paper 176, Scot Law Com No 68).

<sup>63</sup> Fletcher 16.

<sup>64</sup> *Bankruptcy: Interim Report of the Insolvency Law Review Committee* (Cmnd 7968).

<sup>65</sup> Fletcher 17.

Cork Report were implemented, a fact which has had a negative impact on the development of insolvency law in England.<sup>66</sup> Although the law relating to individual and corporate insolvency was merged into one Act, namely the (English) Insolvency Act 1986, the Act itself does not bring about a genuine unification of the law relating to these separate branches of the law.<sup>67</sup> That the aims of the Cork Report were not fully achieved is evident from the following statement made by Fletcher:<sup>68</sup>

“Thus ... the consolidation of all the statutory provisions governing the insolvency of individuals and that of companies within a single Act ... was finally brought about. However, although a high degree of harmonisation has been achieved between many parallel provisions belonging to the different branches of insolvency law, the traditional distinction survives between corporate and personal insolvency ...”

Due to the fact that the recommendations made in the Cork Report are referred to throughout this study, the detail of its recommendations will not be discussed here. However, in view of the objectives of this thesis, it is appropriate to state the main recommendations made by the Cork Committee in Chapter 52 of their report:

- (1) *To simplify and modernise the present cumbersome, complex, archaic and over-technical multiplicity of insolvency procedures, with a view to the harmonisation and integration, wherever possible, of the law and practice relating to the individual and the corporate debtor alike ...*
- (2) *To encourage, wherever possible, the continuation and disposal of the debtor's business as a going concern and the preservation of jobs for at least some of the employees, and to remove obstacles which tend to prevent this ...*
- (3) *In the case of the individual debtor, to reduce the emphasis on 'selling him up' and to increase the attention paid to the possibility of meeting the claims of creditors out of the debtor's future wages or income ...*
- (4) *To improve the standard of administration of insolvent estates and to prevent abuse and also to encourage the ordinary unsecured creditors to take a more active interest in the proceedings ...*
- (5) *To increase the amount available in an insolvent's estate for the ordinary creditors ...*
- (6) *To ensure a fairer distribution of the assets realised in the course of insolvency proceedings and so to allay the dissatisfaction that exists on this subject ...*

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<sup>66</sup> For a discussion of the events that led to only some of the Cork Report recommendations being implemented, see Fletcher 17-20.

<sup>67</sup> Fletcher 20.

<sup>68</sup> Fletcher 20. See also Keay “To Unify or Not to Unify” 65-68.

- (7) *To relax the excessive severity of the law towards the individual insolvent, particularly the insolvent who is incompetent rather than dishonest, but to increase the severity of the law towards the director of the failed company who has acted irresponsibly ...*<sup>69</sup>

## 2.3 Conclusion

To summarise,<sup>70</sup> winding-up law in England originated as a means of bringing about the demise of large trading companies upon their inability to pay their debts. As the concept of the company as a separate legal entity grew in popularity within a highly modernised society and business climate, the winding-up procedures were adapted to meet the ever-changing needs of these artificial juristic persons. The popularity of separate juristic personality brought with it a number of problems, such as abuse by unscrupulous company promoters and directors. As the popularity of companies grew, the need to distinguish (upon insolvency) between individuals and companies diminished, to the point where England, by introducing the Insolvency Act of 1985, sought to do away (as far as possible) with these distinctions. It is unfortunate that the English legislature elected not to implement all the recommendations made by the Cork Committee, as it is evident that its recommendations envisaged a more far-reaching integration of the laws relating to individuals and corporate debtors.<sup>71</sup>

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<sup>69</sup> Cork Report par 1980(1)-(7).

<sup>70</sup> For a useful summary of events in England leading up to and including the recommendations made by the Cork Report, see Keay "To unify or Not to Unify" 62.

<sup>71</sup> It is possible that the Cork Report's recommendations would have properly implemented had it not been for the sudden decision by the government to push through a new Insolvency Act on an urgent basis. Keay "To Unify or Not to Unify" states it thus at 67:

"When the Cork Committee reported, it did so to a government that was different from the one that had originally commissioned it and there was not a great deal of enthusiasm about implementing the recommendations. As so often has occurred in history, given the pragmatism of government in western democracies, a bill was drafted hurriedly in 1984 following several financial scandals in which those involved were able to avoid any personal repercussions... The resultant statute, the Insolvency Act of 1985, was not a unified statute and it failed to introduce many of the recommendations of the Cork Committee."

However, there are many lessons to be learnt from the development of English insolvency law, especially in light of the fact that our own system is largely based on English law. The main lessons to be learnt from the development of English insolvency law are the following:

- (a) Why corporate insolvency law experienced a parallel development with individual insolvency law;
- (b) Political issues can often hamper the proper development of the law. This was illustrated by the fact that all of the recommendations of the Cork Report were not fully implemented;
- (c) That one of the workable alternatives to having a truly unified Insolvency Act is the duplication of the insolvency provisions that apply to both individual and corporate insolvency;
- (d) That incorporating individual and corporate insolvency into one statute does not necessarily bring about a unification of the insolvency laws, especially when the Act still makes a distinction between corporate and individual insolvency.

Although insolvency law in England has developed quite substantially over the centuries, they have still not perfected the unity of their insolvency legislation. Despite this, the English system of insolvency law appears to work quite well in practice.

### 3 AUSTRALIA

#### 3 1 Introduction and historical background

The history of Australian corporate insolvency law followed a very similar pattern to the development experienced in South Africa,<sup>72</sup> in that both are to a large extent based on English law.<sup>73</sup> Consequently Australian corporate insolvency law has, over the years, developed in a similar fashion to South Africa's corporate insolvency legislation. It is interesting to note that in 1988 Australia faced the same dilemma that South Africa now faces: should unified insolvency legislation be introduced or should the current system of dual statutes be retained? Despite the matter having been considered prior to its report,<sup>74</sup> the Australian Law Reform Commission,<sup>75</sup> in a report commonly known as the Harmer Report, did not consider it a "major issue" that needed to be decided and consequently a unified Act was never introduced.<sup>76</sup>

According to Keay<sup>77</sup> the first federal bankruptcy legislation in Australia was enacted in 1924. However, Australian insolvency law to this day follows a dual system of insolvency with

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<sup>72</sup> Australia experienced a "complete acceptance of English law" - see Keay "To Unify or Not to Unify" 68.

<sup>73</sup> See Keay *Insolvency, Personal and Corporate Law and Practice* 3rd ed (1998) 1 (hereinafter referred to as Keay *Insolvency*); Tomasic and Whitford *Australian Insolvency and Bankruptcy Law* 2nd ed (1997) (hereinafter referred to as Tomasic and Whitford). For a discussion of the early history of Australian insolvency law, see Kercher "An indigenous Jurisprudence? Debt Recovery and Insolvency Law in the New South Wales Court of Civil Jurisdiction, 1788 to 1814" 1990 6 *Australian Journal of Law and Society* 1; Keay McPherson, *The Law of Company Liquidation* 4th ed (1999) 20-23 (hereinafter referred to as McPherson); For an interesting look at the early history of bankruptcy, see also Dal Pont and Griggs "The Journey from Ear-cropping and Capital Punishment to the Bankruptcy Legislation Amendment Bill 1995" 1988 8 *Corporate and Business Law Journal* 155.

<sup>74</sup> See ALRC DP32, *General Insolvency Inquiry*, August 1987.

<sup>75</sup> Australian Law Reform Commission Report No 45 *General Insolvency Inquiry* (hereinafter referred as the Harmer Report).

<sup>76</sup> Paras 25-32 of the Harmer Report. However, the Commission's recommendation has since been criticised - see Keay "To Unify or Not to Unify" 68-69 and Keay "The Unity of Insolvency Legislation: Time for a Re-think?" 1999 *Insolvency Law Journal* 7-8.

<sup>77</sup> Keay *Insolvency* 1 fn 16.

individual bankruptcies being regulated by the Bankruptcy Act of 1966 (Cth) and corporate insolvencies being regulated by the Corporations Act.<sup>78</sup> Consequently, as is the case in South Africa, Australia still distinguishes between “bankruptcy” (individuals) and “liquidation” or “winding-up” (corporations).<sup>79</sup>

Because Australia’s insolvency law is partially based on legislation and partially based on common law, various amendments to insolvency legislation has been necessitated over the years.<sup>80</sup> The most recent changes to individual bankruptcy were contained in the Bankruptcy Legislation Amendment Act 1996 (Cth) which came into operation on 16 December 1996.<sup>81</sup> Regarding corporate insolvency law reform, important changes were brought about by the Corporate Law Reform Act 1992 (Cth) which came into operation on 23 June 1993.<sup>82</sup> In the meantime the Corporations Law that contains, *inter alia*, the provisions relating to corporate insolvency, has been renamed the Corporations Act.<sup>83</sup>

Due to the fact that Australia has elected to retain a dual system of insolvency law, any references to Australia insolvency law and law reform will be of limited value for the purposes of this study. However, the Harmer Report does contain some valuable information regarding the approach that can be taken when deciding whether or not to introduce a unified insolvency statute, and it is worth taking note of the advantages and disadvantages in doing so as listed by the Harmer Report.

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<sup>78</sup> Previously known as the Corporations Law. Due to an amendment that came into operation on 15 July 2001, it is now known as the Corporations Act, Act No 50 of 2001.

<sup>79</sup> Key *Insolvency* 2. See also the Harmer Report par 22, where retaining the use of the existing terminology was recommended.

<sup>80</sup> Key *Insolvency* 3.

<sup>81</sup> Key *Insolvency* 3.

<sup>82</sup> Key *Insolvency* 3-4. See also Tomasic and Whitford 2-3.

<sup>83</sup> Act No 50 of 2001. This Act came into operation on 15 July 2001.

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### 3 2 The Harmer Report<sup>84</sup>

The Harmer Report was published in 1988 and according to its terms of reference, the Commission was asked to inquire into:

“the law and practice relating to the insolvency of both individuals and bodies corporate, in particular -

- (i) the provisions of the Bankruptcy Act 1966, in its application to both business and non-business debtors;
- (ii) Parts VIII, X, XII of the Companies Act 1981 so far as they are related to or concerned with the insolvency of companies;
- (iii) any related matter”.<sup>85</sup>

This reference provided the first opportunity in Australia for a comprehensive review of its insolvency laws, as the last review had been undertaken by the Clyne Committee between 1956 and 1962, dealing only with individual insolvencies.<sup>86</sup>

In the main, the Harmer Report is divided into five main parts. The first part deals with introductory aspects and a number of general issues. Part II deals exclusively with corporate insolvency, Part III exclusively with consumer bankruptcy issues and Part IV with aspects relating to both consumer and corporate insolvency. The last part of the Report, published as a separate volume or appendix, contains recommendations in the form of draft legislation.

The question of whether or not to introduce unified insolvency legislation was one of the major issues in the commission’s terms of reference.<sup>87</sup> After having referred to the United States and

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<sup>84</sup> The Harmer Report will be referred to throughout the remaining chapters of this thesis, as many issues facing the unification of the South African insolvency statutes are touched upon in the report. Although Australia elected not to introduce a unified insolvency statute, the issues that could have led to the introduction of such a statute are dealt with in the report, and it is a useful work of reference when determining whether or not a unified insolvency statute is desirable.

<sup>85</sup> Harmer Report par 2.

<sup>86</sup> Harmer Report par 3.

<sup>87</sup> Harmer Report par 25.

England as examples of overseas countries having adopted a unified system to a larger or lesser extent,<sup>88</sup> the report looked at various aspects of this issue before coming to the following conclusion:

“While the Commission accepts that there are advantages in unified insolvency legislation it does not regard the goal of unity to be one of major significance.”<sup>89</sup>

In reaching this conclusion the Commission looked at constitutional considerations in Australia,<sup>90</sup> arguments for and against unified legislation,<sup>91</sup> and the proposals made in DP 32.<sup>92</sup> The Harmer Report then lists the following as the advantages of having unified legislation:<sup>93</sup>

- (a) Many of the aspects regulating the insolvency of individuals and corporations are or should be the same;
- (b) In an Australian context a single statutory scheme would mean that only one government (that of the Commonwealth of Australia) would have effective control of insolvency policy, and changes could be made expeditiously;
- (c) Common procedures would be cost effective.

The Harmer Report also referred to a previous commission of inquiry, commonly known as DP 32, in order to point out some of the reasons for not implementing a unified insolvency statute. These are listed as follows in the Harmer Report:

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<sup>88</sup> Harmer Report par 26.

<sup>89</sup> Harmer Report par 31.

<sup>90</sup> Harmer Report par 27.

<sup>91</sup> Harmer Report par 28.

<sup>92</sup> Harmer Report par 29. The reference to DP 32 is a reference to Australian Law Reform Commission of Inquiry ALRC DP32, *General Insolvency Inquiry*, August 1987.

<sup>93</sup> Harmer Report par 28.

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- (a) “Irreconcilable differences”. According to the report in DP 32 there are too many differences between individuals and corporations to bring about complete unity;<sup>94</sup>
- (b) “Jurisdictional difficulties”. According to the report in DP 32 unified insolvency legislation would have to be federal legislation. The question arose as to which courts, federal or state courts, would have jurisdiction. The report in DP 32 saw this as possibly giving rise to constitutional and political issues.<sup>95</sup>
- (c) “Reform, not form, important”. The report in DP 32 saw the reform of both individual and corporate insolvency as being more important than the unification of the provisions.<sup>96</sup>
- (d) “National companies legislation”. The report in DP 32 stated that national legislation regulating insolvency would go a long way towards the goal of ensuring uniformity due to the centralisation of the legislation under one government. In other words the uniformity of the substantive law was seen to be more important than the merger of the provisions into one Act.<sup>97</sup>

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<sup>94</sup> As will be shown under part 4 of this study, the differences between individual and corporate insolvency are not as irreconcilable as one might expect. In fact, the SA Law Commission stated in SA Law Commission Project 63 Commission Paper 582 (11 Feb 2000) Vol 1 par 5.2.1 (hereinafter referred to as Commission Paper 582): “Once a start has been made it is surprising how easy it is to unify the provisions.”

<sup>95</sup> This problem will not be experienced in South Africa, as a separate system of state and federal courts does not exist here.

<sup>96</sup> While this statement is not entirely incorrect, it does lose sight of the fact that, in the long term, reform will be a lot easier to implement once a unified Act is in place. Having to reform the same principles contained in separate legislation will be a lot more difficult than reforming principles contained in a single insolvency statute.

<sup>97</sup> This statement is also not entirely incorrect, but loses sight of the fact that the amendment of the substantive law in a unified Act would be far easier to achieve than having the law spread over various statutes. However, the reason for the statement seems to be based more on constitutional issues than the principles of insolvency.

### 3 3 Australian insolvency legislation and philosophy

As stated above, Australian insolvency legislation is dealt with in two statutes. Individual or consumer bankruptcy is dealt with in the Bankruptcy Act of 1966 (Cth). Corporate insolvency, on the other hand, is dealt with in Part 5 of the Corporations Act. Unlike the position in South Africa,<sup>98</sup> however, the Australian corporate insolvency law is completely separate from the law regulating the insolvency of individuals. This means that there is no connecting clause or section that makes the Bankruptcy Act applicable also to corporate insolvency. Each statute regulating consumer bankruptcies and corporate insolvency contains its own, complete set of rules that can be applied to the administration of that specific type of entity or individual.<sup>99</sup>

For the purposes of this project the Australian Corporations Act is of particular importance, and will consequently be referred to throughout the remainder of this study. As regards the current philosophy of Australian insolvency law, the main principles or aims of their insolvency law was summarised as follows by the Harmer Report:<sup>100</sup>

- (a) To provide a fair and orderly process for dealing with the financial affairs of insolvent individuals and companies;
- (b) To provide mechanisms that enable both debtor and creditor to participate with the least possible delay and expense;
- (c) To provide for an insolvency administration that is impartial, efficient and expeditious;

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<sup>98</sup> Under South African law the Insolvency Act also applies to companies that are wound up under the Companies Act 61 of 1973 (hereinafter referred to as the Companies Act) and that are unable to pay their debts. S 339 of the Companies Act makes the Insolvency Act 24 of 1936 (hereinafter referred to as the Insolvency Act) applicable in such cases, a feature not found in Australian legislation. For a discussion of s 339 of the Companies Act, see ch 5 below.

<sup>99</sup> Keay *Insolvency* 361.

<sup>100</sup> Harmer Report par 33 15-17.

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- (d) To provide a convenient means of collecting or recovering property that should properly be applied toward payment of the debts and liabilities of the insolvent person;
  - (e) To retain the principle of equal sharing between creditors, and to reinforce such principle in some areas;
  - (f) To ensure that the end result of an insolvency administration is the effective relief or release from the financial liabilities and obligations of the insolvent;
  - (g) To ensure that insolvency law, so far as it is convenient and practical, supports the commercial and economic processes of the community;
  - (h) To harmonise, as far as is possible and practicable, insolvency law with the general law;
  - (i) To enable ancillary assistance in the administration of an insolvency originating in a foreign country.

### 3 4 Conclusion

Although Australian insolvency and winding-up law is very similar to its South African counterparts, the fact remains that the Harmer Report chose not to recommend a unified statute. From the Harmer Report it is evident that the Commission of Inquiry chose only to concentrate on law reform and not on introducing a unified insolvency statute.<sup>101</sup> In fact, in rejecting a uniform insolvency statute, the Report states at paragraph 31:

“It is more important to concentrate on the particular reform proposals put forward in this Report than to be overly concerned with attempting to put the two very different aspects of insolvency law into one Act. However, as far as possible and necessary, the Commission has sought in the Report to promote the uniformity of the substance of the provisions relating to individual and corporate insolvency.”

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<sup>101</sup> Harmer Report par 31.

As stated above, the fact that the Commission chose not to introduce a unified Act has since been criticised.<sup>102</sup> On the other hand, it would appear that Australian insolvency legislation has at least succeeded in avoiding the pitfalls of a “connecting clause” that makes the rules of insolvency relating to individuals applicable also to corporate insolvency. The Australian Corporations Act contains its own complete set of rules regulating insolvency, and it is not necessary to refer back to the Bankruptcy Act in order to find the law relating to a specific issue.<sup>103</sup> This is in contrast to South African statutes, where section 339 of the Companies Act refers back to the laws regulating insolvency where the Companies Act does not contain a provision dealing with the problem at hand. It is submitted that section 339 of the Companies Act is the cause of most of the problems relating to the dual insolvency system in South Africa.<sup>104</sup>

The fact that Australia has a federal system of government also played a role in the commission deciding against unified insolvency legislation,<sup>105</sup> a fact that can be attributed more to constitutional issues than insolvency law considerations. Serious policy and political issues are raised when enacting federal legislation (or Commonwealth legislation as it is sometimes referred to), a problem that South Africa will not encounter when having to decide such an issue.<sup>106</sup> From the commission’s report it is also evident that a dual system of insolvency law works quite well in Australia, otherwise the commission would surely have recommended the unification of the various statutes.

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<sup>102</sup> See Key “To Unify or Not to Unify” 68-69 and Key “The Unity of Insolvency” Legislation 7-8.

<sup>103</sup> Key *Insolvency* 361.

<sup>104</sup> This aspect is dealt with in more detail in the conclusion contained in part 5 of this thesis.

<sup>105</sup> See paras 29 and 32 of the Harmer Report.

<sup>106</sup> However, there are still some political issues that South Africa will experience. Eg, the Insolvency Act is administered by the Department of Justice and Constitutional Development while the Companies Act, to name but one example, is administered by the Department of Trade and Industry. Vested interests may yet cause the promulgation of a unified insolvency statute to fail in South Africa.

## 4 GERMANY

### 4.1 Introduction

The reason for selecting the Federal Republic of Germany as one of the jurisdictions to be discussed on a comparative basis, is the fact that Germany has recently adopted a unified insolvency statute.<sup>107</sup> Not only is the *Insolvenzordnung* of 1994 unified in the sense that it creates a “single gateway” approach to insolvency and business rescue, but it also happens to be unified in the sense that the insolvency enactments of the Federal Republic of Germany and the former German Democratic Republic (GDR) are now contained in a single statute.<sup>108</sup> It has taken a number of years for the *Insolvenzordnung* to be promulgated, and the fact that it has taken so long may cast some light on the problems experienced by Germany in obtaining a single insolvency statute.<sup>109</sup> In this chapter the historical development of German insolvency law will be traced, examining events that led to the promulgation of the *Insolvenzordnung* that currently finds application. The law reform programme that Germany followed will also be scrutinised in order to determine what the current philosophy is regarding German corporate insolvency law.

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<sup>107</sup> *Insolvenzordnung vom 5 Oktober 1994 (BGBl. I, S. 2866)* - hereinafter referred to as the Insolvency Code of 1994. This Code came into operation on 1 January 1999.

<sup>108</sup> See Stewart *Insolvency Code - Act Introducing the Insolvency Code* (1997) 6; Schäfer “Limitations on Secured Creditors’ Rights” <http://themis.wustl.edu/ibll/bank/Schaefer.htm> (accessed on 18 March 2001) (hereinafter referred to as Schäfer).

<sup>109</sup> At this point it is interesting to note that Stewart 6 states that the reason for the late implementation is the result of negotiations between the German government and the judiciary. Apparently the judiciary was afraid that it would be unable to deal with the flood of insolvency matters that would arise from the promulgation of the Code. It is assumed that the simplified insolvency application procedure contained in the Code would lead to the flood of applications. See also Schäfer, who points out that the delay was due to organisational changes in the judiciary.

## 4 2 Historical development of German insolvency law<sup>110</sup>

Dalhuisen<sup>111</sup> states that no uniform system of insolvency law existed in Germany during its early history. Only individual remedies were available for creditors until as late as the fifteenth and sixteenth centuries.<sup>112</sup> However, in some of the Hanseatic cities a bankruptcy procedure did exist from the thirteenth century onwards, although initially only in regard to dead or absconding debtors.<sup>113</sup> Italian influence resulted in more sophistication in regard to the bankruptcy laws, a fact evident from the Hamburg city laws of 1603 and 1605 and the law of Nuremberg of 1564.<sup>114</sup> The further development of these laws under Italian influence could also be seen in the laws of Freiburg (1520), Frankfurt (1578), Bavaria (1611 and 1616), Saxony (1622 and 1724), Gotha (1670), Eisenach (1702) and the later Hamburg regulations of 1753.<sup>115</sup>

The *cessio bonorum* was recognised by the laws of Bavaria and the law of Wuerttemberg of 1610 for the honest but unfortunate debtor in order to avoid going to prison.<sup>116</sup> In the seventeenth and eighteenth centuries the writings of Salgado de Samoza is said to have caused a Spanish law influence over developments in Germany.<sup>117</sup> According to Dalhuisen<sup>118</sup> the Spanish influence can

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<sup>110</sup> For a detailed discussion of the early German insolvency laws, see Wood and Totty *Butterworths International Insolvency Laws* (1994) 172-255.

<sup>111</sup> Dalhuisen par 2.02[7] 1-37.

<sup>112</sup> Dalhuisen par 2.02[7] 1-37.

<sup>113</sup> Dalhuisen par 2.02[7] 1-37. This system was also subsequently adopted by Bremen and Hamburg.

<sup>114</sup> Dalhuisen par 2.02[7] 1-37.

<sup>115</sup> Dalhuisen par 2.02[7] 1-37.

<sup>116</sup> Dalhuisen par 2.02[7] 1-37–1-38. This procedure provided for a kind of discharge by granting the *beneficium competentiae*, and this resulted in the debtor not needing to do more than he reasonably could to repay his debts - see Dalhuisen par 2.02[7] 1-38.

<sup>117</sup> Dalhuisen par 2.02[7] 1-38.

<sup>118</sup> Dalhuisen par 2.02[7] 1-38.

be detected in the laws of Bavaria of 1753,<sup>119</sup> the Prussian ordinances of 1718 and 1722, the Prussian Code of 1781, the Prussian *Gerichtsordnung* of 1793, the Codes of Lippe Detmold (1779), Hannover (1850) and Baden (1864).<sup>120</sup> Germany was not unified at the beginning of the nineteenth century and consequently state law prevailed at the time.<sup>121</sup> These laws were based on Roman law concepts that had been received and amended into Germany.<sup>122</sup> In some states, such as Bavaria and Prussia, codification took place in the eighteenth and nineteenth centuries.<sup>123</sup> In Hanover in 1850 and in Baden in 1869 new codes were promulgated, and in Bavaria a new code of civil procedure<sup>124</sup> was enacted in 1869. In 1855 separate bankruptcy legislation had been enacted in Prussia,<sup>125</sup> and while bankruptcy law also existed in other cities, in the other states insolvency law had not been codified.<sup>126</sup>

After German unification new codes were introduced on a gradual basis. This ultimately led to the all-German Codes of 1900.<sup>127</sup> The 1877 Bankruptcy Act<sup>128</sup> was eventually passed, but only came into operation in 1879.<sup>129</sup> This Act was amended in 1898 to bring it into line with the

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<sup>119</sup> *Codex Bavaricus Judiciarius*.

<sup>120</sup> For a discussion of the systems of insolvency under these laws see Dalhuisen par 2.02[7] 1-38.

<sup>121</sup> Dalhuisen par 3.07[1] 1-82.

<sup>122</sup> Dalhuisen par 3.07[1] 1-82.

<sup>123</sup> Dalhuisen par 3.07[1] 1-82.

<sup>124</sup> *Bayerische Prozessordnung*, Book V - see Dalhuisen par 3.07[1] 1-82.

<sup>125</sup> *Preussische Konkursordnung* - see Dalhuisen par 3.07[1] 1-82.

<sup>126</sup> Dalhuisen par 3.07[1] 1-82.

<sup>127</sup> Dalhuisen par 3.07[2] 1-82.

<sup>128</sup> *Reichs-Gesetzblatt* 351 of 10 February 1877. The underlying ideas contained in this Act came mainly from Prussian and Bavarian bankruptcy laws of 1855 and 1869 respectively, although it is thought that the French law of 1838 also had some influence - see Dalhuisen par 3.07[2] 1-82.

<sup>129</sup> Dalhuisen par 3.07[2] 1-82.

provisions of the new German Civil Code of 1900.<sup>130</sup> The original German Bankruptcy Code that was passed in 1877<sup>131</sup> was, according to commentators,<sup>132</sup> during the “Promoters’ Age”<sup>133</sup> which was a period of escalating industrialisation in Germany. According to Stewart<sup>134</sup> the Bankruptcy Code contained “classical liberal theories” and was seen by many as a mechanism for “separating the economic chaff from the economic wheat.” Stewart states this as one of the reasons why the Bankruptcy Code was criticised for its alien roots once the traditional socialistic, centralistic German economic thinking gained a foothold.

In 1893 a bill to amend the Bankruptcy Code was tabled, which eventually resulted in the Bankruptcy Code of 20 May 1898.<sup>135</sup> From Stewart’s comments<sup>136</sup> it is evident that the existing Bankruptcy Code was criticised due it being tailored to meet the needs of big business, and because it was based on the idea of debtor’s fault. In addition to the Bankruptcy Code, the Reorganisation Code<sup>137</sup> was introduced in 1935 to meet the need of providing relief to honest debtors without having to use the bankruptcy procedure.<sup>138</sup>

In the post-World War II era in Germany’s history, which was a an era of sustained recovery, growth and prosperity, there was little or no reason for anyone to object to the foreign roots of

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<sup>130</sup> Dalhuisen par 3.07[2] 1-82.

<sup>131</sup> Stewart 8.

<sup>132</sup> Stewart 8.

<sup>133</sup> Stewart 8 refers to it as the so-called “*Gründerzeit*”.

<sup>134</sup> Stewart 8.

<sup>135</sup> *Konkursordnung* of 20 May 1898 (RGBl p 612; BGBl III No 311-4).

<sup>136</sup> Stewart 8.

<sup>137</sup> *Vergleichsordnung* of 26 February 1935 (RGBl I p 217; BGBl I p 1185). See also Dalhuisen par 3.07[2] 1-84.

<sup>138</sup> Stewart 8. However, it is submitted that under the Reorganisation Code an agreement would only have been possible if the debtor had sufficient assets in order to make the agreement effective. It is unlikely that an agreement would have been reached if the debtor had no or negligible assets.

the Bankruptcy Code.<sup>139</sup> However, the presence of the social state and its resultant social market economy increasingly sought to bring about a form of debtor relief that would ultimately seek to protect jobs.<sup>140</sup>

In 1978 the Ministry of Justice appointed an independent committee to recommend an insolvency law that is effective, modern, business-orientated and socially relevant.<sup>141</sup> It was also necessary for the new insolvency law to include a procedure that could save a company in financial difficulty, but which would be acceptable to creditors.<sup>142</sup> This committee presented its proposals in 1985, which included a unified insolvency proceeding as well as an effective business rescue proceeding.<sup>143</sup>

In 1988 a “Discussion Draft of a Statute Reforming Insolvency Law”<sup>144</sup> was published by the Ministry of Justice, but this draft took a much harder line than the aforementioned committee’s report.<sup>145</sup> This draft was followed in 1989 by the Ministry of Justice’s final draft, the “Experts’ Draft of a Statute Reforming Insolvency Law”.<sup>146</sup>

With the fall of East Germany in the late 1980s, it became necessary to integrate East Germany’s insolvency proceedings into West Germany’s legal framework.<sup>147</sup> To this end the Aggregate

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<sup>139</sup> See Stewart 9.

<sup>140</sup> Stewart 9.

<sup>141</sup> Stewart 9.

<sup>142</sup> Stewart 9.

<sup>143</sup> Stewart 9.

<sup>144</sup> *“Diskussions-Entwurf eines Gesetzes zur Reform des Insolvenzrechts.”*

<sup>145</sup> Stewart 9.

<sup>146</sup> *“Referenten-Entwurf eines Gesetzes zur Reform des Insolvenzrechts.”*

<sup>147</sup> Stewart 9-10.

Execution Code<sup>148</sup> that applied in East Germany was amended<sup>149</sup> and adopted for application in the former German Democratic Republic.<sup>150</sup> In 1991 the government released the Government Draft of an Insolvency Code,<sup>151</sup> and in 1992 it released a draft Introductory Statute<sup>152</sup> that included a total redrafting of the Statute on Noninsolvency Avoidance of Transactions by the Debtor<sup>153</sup> and detailed provisions on international application of the insolvency statute.<sup>154</sup>

In the meantime, the interim measures that had been made applicable to insolvency proceedings in East Germany, were as a result of the wider law reform programme taking place in West Germany. The idea was that the East German law would be repealed and brought into line with West German law with the promulgation of a new insolvency statute.<sup>155</sup>

The government's draft of a new insolvency statute was debated at a committee hearing of the Legal Committee of the *Deutscher Bundestag*<sup>156</sup> with many critical voices being raised against the draft.<sup>157</sup> In response to this criticism, the committee proposed various changes to the statute which included a special proceeding in respect of consumer insolvencies.<sup>158</sup> The committee's new draft was accepted by the *Bundestag* and the Bill was passed in April 1994.<sup>159</sup>

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<sup>148</sup> "Gesamtvollstreckungsordnung."

<sup>149</sup> See the version of the *Gesamtvollstreckungsordnung* promulgated on 23 May 1991 (BGBl I p 1185).

<sup>150</sup> Stewart 9-10.

<sup>151</sup> "Regierungs-Entwurf einer Insolvenzordnung."

<sup>152</sup> "Entwurf eines Einführungsgesetzes zur Insolvenzordnung."

<sup>153</sup> "Anfechtungsgesetz."

<sup>154</sup> Stewart 10.

<sup>155</sup> See Schäfer.

<sup>156</sup> The German Lower House of Parliament.

<sup>157</sup> Stewart 10.

<sup>158</sup> Stewart 10.

<sup>159</sup> Stewart 10.

The *Bundesrat*,<sup>160</sup> however, objected to the proposals by appealing to the *Vermittlungsausschuß*<sup>161</sup> and demanded that provision be made for the increased burden on the courts that the proposals were likely to cause.<sup>162</sup> The *Bundesrat* also demanded a formally separate consumer proceeding. In response to these demands the *Vermittlungsausschuß*'s only response was to delay the effective date of the statute to 1 January 1999, and ignored all other demands by the *Bundesrat*.<sup>163</sup> The *Vermittlungsausschuß*'s proposals were approved by the *Bundestag* on 17 June 1994 and by the *Bundesrat* on 18 July 1994.<sup>164</sup> The final statutes, namely the *Insolvenzordnung* (Insolvency Code) and the *Einführungsgesetz zur Insolvenzordnung* (Introductory Statute) were published in the *Bundesgesetzblatt* (Federal Legislative Register) on 5 October 1994.<sup>165</sup>

As of 1 January 1999, the *Insolvenzordnung* (Insolvency Code) of 5 October 1994 has replaced the previous insolvency statute, the *Konkursordnung* (Bankruptcy Code) of 20 May 1898, the *Vergleichsordnung* (Reorganisation Code) of 26 February 1935 and the *Gesamptsvollstreckungsordnung* (Aggregate Execution Code) of 23 May 1991. According to Stewart<sup>166</sup> the *Einführungsgesetz zur Insolvenzordnung* (Act Introducing the Insolvency Code) of 5 October 1994 completely amends the *Anfechtungsgesetz* (Statute on Noninsolvency Avoidance of Transactions by the Debtor) of 20 May 1898. In addition, the promulgation of Germany's new insolvency statute has brought about the repeal of nine statutes and the amendment of 99 other statutes.<sup>167</sup>

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<sup>160</sup> The German Upper House of Parliament.

<sup>161</sup> Conference Committee.

<sup>162</sup> Stewart 10. See also Schäfer.

<sup>163</sup> Stewart 10.

<sup>164</sup> Stewart 10.

<sup>165</sup> Stewart 10. See also Paulus "The New German Insolvency Code" 1998 33 *Texas International Law Journal* 141-155 (hereinafter referred to as Paulus).

<sup>166</sup> Stewart 10.

<sup>167</sup> Stewart 10. For a useful summary of the mechanics of the new German Insolvency Code, see Paulus 141-155.

### 4 3 Current philosophy of German insolvency law

Although there are, according to Stewart,<sup>168</sup> still some serious shortcomings in the German framework of insolvency law, it must be said that Germany has now introduced a truly unified insolvency statute that contains many similarities with the United States Bankruptcy Code.<sup>169</sup> What makes the German Insolvency Code remarkable in the innovative sense, is that they have introduced a “single gateway” approach to insolvency, where all bankruptcies are filed through the insolvency courts.<sup>170</sup> This is similar to the United States system of bankruptcy that is operated through a well organised system of bankruptcy courts.

The current philosophy of German insolvency law is evident from the following underlying principles of the new Bankruptcy Code:<sup>171</sup>

- (a) *Unified insolvency proceedings.*<sup>172</sup> The German Insolvency Code has introduced a unified insolvency system that streamlines and consolidates all the previous legislation that existed in regard to insolvency law.<sup>173</sup> Included in this new system is a revised approach towards reorganisations which now provides for an ailing business to seek help before recovery of the business becomes impossible. This has been done by removing the insolvency requirement before a reorganisation can be entered into, replacing it with a more attainable requirement, namely “threatened illiquidity”.<sup>174</sup> In addition to this, the German

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<sup>168</sup> Stewart 10-17.

<sup>169</sup> United States Bankruptcy Code, 11 USC. See Stewart 11.

<sup>170</sup> However, this “innovation” is not really that new as the insolvency courts, as part of the local country courts, had already existed under the *Konkursordnung*.

<sup>171</sup> See generally Stewart 11-16; Paulus 143-144.

<sup>172</sup> See Paulus 143.

<sup>173</sup> Stewart 11.

<sup>174</sup> Stewart 11.

Insolvency Code also introduces a system whereby the debtor may manage the bankruptcy on its own, subject to the supervision of an administrator. These provisions are very similar to the United States' "debtor-in-possession" principles provided for in the United States Bankruptcy Code.<sup>175</sup> Finally, the German Insolvency Code is also "unified" in the sense that there is now one Insolvency Code for the entire territory that previously consisted of the Federal Republic of Germany and the German Democratic Republic.<sup>176</sup>

- (b) *Increased creditor independence.*<sup>177</sup> According to Stewart<sup>178</sup> the German Insolvency Code attempts to strike a balance between creditors running their own affairs in insolvency proceedings, and subordinating creditors' rights for the common good. This is done by giving creditors a large degree of independence, but at the same time allowing the court to overrule the conduct of creditors where it is required. These rights of the creditors are interspersed between a number of provisions, but the Insolvency Code achieves its goal by allowing creditors more rights in regard to various administrative procedures, for example the right to appoint their own administrator and the right to constitute a creditors committee.<sup>179</sup> This independence that has been given to the creditors is tempered by the court's powers to overrule them should they overstep the mark.<sup>180</sup>
- (c) *Avoidance measures.* Although not really pertinent to the scope of this study, it is worth pointing out that the German Insolvency Code has tightened the measures relating to the avoidance of antecedent transactions. One of the interesting aspects of this is the fact that

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<sup>175</sup> Stewart 11.

<sup>176</sup> Stewart 11.

<sup>177</sup> See Paulus 143.

<sup>178</sup> Stewart 11.

<sup>179</sup> This aspect of creditor independence is also not a new concept. Under the *Konkursordnung* the creditors also had the right to elect their own trustee at the first creditors meeting.

<sup>180</sup> Stewart 11-12.

they have reduced the burden of proof by removing the need to prove actual intent by the debtor. By introducing gross negligence as an objective test, and by introducing a number of presumptions in this regard, the avoidance provisions have been substantially tightened.<sup>181</sup>

- (d) *Secured creditors.* In contrast to the previous insolvency laws that applied in Germany, secured creditors are also now included in insolvency proceedings. However, their rights are limited in certain respects, especially as regards the ambit of their secured rights, although they are allowed to participate and vote in the creditors' assembly.<sup>182</sup>
- (e) *Labour issues.*<sup>183</sup> An important issue in any country's insolvency laws today, the German Insolvency Code goes a long way towards protecting employees in insolvency. According to Stewart there are sixteen provisions in the German Insolvency Code that directly address labour issues. However, the Insolvency Code does strive to strike a balance and does not try to preserve jobs at the expense of everything else. What it does do, however, is to anchor labour law principles firmly into insolvency. An example of this is the right of employees to be represented in a creditors' committee.<sup>184</sup>

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<sup>181</sup> Stewart 12.

<sup>182</sup> Although secured creditors are able to participate in the procedures, they have no "real" part in the proceeding because they are not seen as bankruptcy creditors. This is so because their claims are settled apart from the bankruptcy procedures, and not out of the other estate assets as ordinary creditors' claims would be.

<sup>183</sup> Stewart 14; Paulus 144.

<sup>184</sup> For more detail regarding labour issues in the German Insolvency Code see Stewart 14-15. This has also become a trend in South African insolvency law: eg s 38 of the Insolvency Act (dealing with the termination of employment contracts); s 197 of the Labour Relations Act 66 of 1995 (dealing with the obligation of a purchaser of a business to take over the existing employment contracts of that business); s 98A of the Insolvency Act (providing for an improved dispensation for employees arrear salary claims upon the insolvency of the employer).

- (f) *Release from remaining liabilities.*<sup>185</sup> Although a complete “fresh start” is not afforded debtors under the German Insolvency Code, sections 286-303 of the Insolvency Code do provide some relief to *bona fide* debtors who co-operate with the administrator, the court and the creditors.<sup>186</sup>
- (g) *Proceedings relating to consumer bankruptcy, and other simplified proceedings.* It is interesting to note that German insolvency law attempts, as far as possible, to keep consumer bankruptcy cases out of the courts and therefore out of the formal proceedings.<sup>187</sup> This is done by only allowing consumer debtors to enter an insolvency proceeding if all other attempts at reaching an arrangement with the creditors have failed. These “other attempts” that are referred to consist of extra-judicial agreements, debt adjustment plans and a release from remaining liabilities.<sup>188</sup> These alternatives to bankruptcy are contained in a simplified, inexpensive proceeding in Part Nine of the Insolvency Code. Briefly stated, these alternatives to consumer bankruptcy are designed to make it more attractive to creditors to enter into agreements with the debtor for the re-scheduling and repayment of debt. Failing an agreement within these extra-judicial guidelines, the debtor can petition the court to enter insolvency proceedings, resulting in bigger losses for the creditors and, more importantly, bringing about a discharge for the

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<sup>185</sup> See Paulus 143.

<sup>186</sup> Stewart 16. It must be pointed out that only consumer debtors qualify for a fresh start. It is also worth pointing out that some of the regulations of the old *Vergleichsordnung* were incorporated into ss 286-303 of the *Insolvenzordnung*.

<sup>187</sup> See part nine of the German Insolvency Code.

<sup>188</sup> These innovations in the German Insolvency Code appear to be similar to common-law compositions, administration orders and statutory compositions under South African law.

debtor.<sup>189</sup> The provisions are therefore designed to make it clear to both the debtor and the creditor that it is advisable to enter into an extra-judicial settlement.<sup>190</sup>

#### 4 4 Conclusion

Although the Federal Republic of Germany has adopted what can be described as one of the most modern (unified) insolvency systems at present, the underlying principles of their Code is only of limited use in a South African context. It is worth expanding on this view:

- (a) In the first place German insolvency law makes use of specialist insolvency courts, something that will not become a feature of South African insolvency law for a long time to come, if ever.<sup>191</sup> By having a system of insolvency courts it is possible to have a “single gateway” approach to bankruptcy where all debtors are able to use the same procedure to obtain relief. This system also presupposes a reasonably debtor-friendly system whereby relief will be given to those seeking it.<sup>192</sup> In South Africa there is not only an absence of insolvency courts, but the use of a creditor-friendly system requires that there must be some pecuniary benefit to creditors by the use of insolvency proceedings.<sup>193</sup>

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<sup>189</sup> Stewart 16.

<sup>190</sup> Stewart 16. Once again, however, it must be pointed out that an agreement with the creditors can only work if the debtor has substantial assets. If there are no or negligible assets the commencement of insolvency proceedings against the debtor will be a relief to the consumer, because the compulsory execution by single creditors ends and is replaced by orderly insolvency proceedings.

<sup>191</sup> See *Commission of Inquiry into the Rationalisation of the Provincial and Local Divisions of the Supreme Court* Third and Final Report Vol 1 Book 1 (also known as the Hoexter Commission Report).

<sup>192</sup> In the case of consumer bankruptcy, however, this is subject to the extra-judicial alternatives having been exhausted.

<sup>193</sup> An anomalous situation arises in South Africa in that consumer insolvency requires a benefit to creditors and also forms the basis of South African insolvency law. In the case of corporate insolvency, no benefit to creditors needs to be proved and a company, eg, may even be liquidated by means of a special resolution.

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- (b) Secondly, it is evident from the German Insolvency Code that creditors actively participate in insolvency proceedings. This is unfortunately not the case in South Africa, where creditors tend to be rather apathetic when it comes to actively participating in insolvency proceedings. By involving creditors in what is essentially their own affairs, the need for supervision and intervention in German insolvency law is limited to those instances where this becomes necessary to protect the rights of creditors as a whole.<sup>194</sup>

Despite what has been stated above, the German Insolvency Code is in my view a bold, modern piece of insolvency legislation that strikes a sound balance between a simplified insolvency procedure and the protection of debtor and creditor rights. The Germans have evidently taken a leaf out of the very liberal bankruptcy laws of the United States, and have successfully adapted these principles to their own unique situation. South Africa can learn from the German experience by introducing a uniform insolvency statute, despite the fact that the initial promulgation of such an Act may turn out to be defective in certain areas in practice. Defects in the system will eventually show themselves and can be rectified by means of amendments, an approach which is employed to good effect in, for example, the United States.<sup>195</sup>

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<sup>194</sup> In South Africa creditors do not act independently or without supervision. The Master of the High Court is a government institution that supervises the administration of all estates. However, South African insolvency does allow for a high degree of participation by the creditors.

<sup>195</sup> See par 5 below.

## 5 UNITED STATES OF AMERICA<sup>196</sup>

### 5.1 Introduction

As explained earlier in this study, the United States as an insolvency jurisdiction has been selected because it has a completely unified system of insolvency law. As such it could possibly serve as a template for insolvency law reform worldwide, and not only in South Africa. An additional reason for including this insolvency jurisdiction is the fact its bankruptcy system also has its roots in English law.<sup>197</sup> What makes the American system of bankruptcy so fascinating is the fact that it has developed tremendously, especially in the last century or so. In fact, the American system of insolvency has developed to such an extent that it is barely recognisable from the insolvency system from which it obtained its roots, namely English insolvency law.

In this brief review of American bankruptcy law, the focus will be on the development of its insolvency system from its English roots to its current form. Of special interest will be the wholesale reform that took place in 1978, the reasons behind the reforms and the current philosophy underlying insolvency law in the United States. Of special importance will be determining how the United States was able to introduce such a liberal system of insolvency, while other countries to a large extent still rely on relatively conservative historical rules in this field of the law.

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<sup>196</sup> See generally Tabb “The History of the Bankruptcy Laws in the United States” 1995 (June) *ABI Law Review* 5-51 (hereinafter referred to as Tabb); Skeel “The Genius of the 1898 Bankruptcy Act” 1999 15(2) *Bankruptcy Developments Journal* 321-341 (hereinafter referred to as Skeel); Tabb “A Century of Regress or Progress? A Political History of Bankruptcy” 1999 15(2) *Bankruptcy Developments Journal* 343-381 (hereinafter referred to as Tabb “Regress or Progress?”); Klee “Legislative History of the New Bankruptcy Code” 1980 54(3) *American Bankruptcy Law Journal* 275-297 (hereinafter referred to as Klee); Kennedy and Clift “An Historical Analysis of Insolvency Laws and Their Impact on the Role, Power, and Jurisdiction of Today’s United States Bankruptcy Court and Its Judicial Officers” 9 *Journal of Bankruptcy Law and Practice* 165-200 (hereinafter referred to as Kennedy and Clift); Dalhuisen par 3.09 1-94–1-117; Herbert *Understanding Bankruptcy* (1995) ch 3 and ch 4 (hereinafter referred to as Herbert); Jackson *The Logic and Limits of Bankruptcy* (1986) 1-19 (hereinafter referred to as Jackson); Albergotti *Understanding Bankruptcy in the US: A Handbook of Law and Practice* (1992) 1-3 (hereinafter referred to as Albergotti). For detailed treatises on the history of United States bankruptcy laws, see Coleman *Debtors and Creditors in America* (1974); Warren *Bankruptcy in United States History* (1935).

<sup>197</sup> Tabb 6.

## 5 2 American bankruptcy laws prior to 1978

The United States Constitution includes the power to enact uniform laws on the subject of bankruptcies.<sup>198</sup> It is evident that the drafters of the Constitution had the English insolvency system in mind when including this power in the Constitution, as the first United States bankruptcy law which was passed in 1800, virtually copied the English law of that time.<sup>199</sup> It can therefore be stated that the United States bankruptcy laws have their conceptual origins in the English bankruptcy laws that existed prior to 1800.<sup>200</sup> Consequently United States bankruptcy laws were initially of a pro-creditor nature, something which has changed over the years as the United States now has a pro-debtor system.

As regards the early insolvency laws that applied in the United States, reference is made to the first bankruptcy laws passed in England, namely the 1542 Act<sup>201</sup> that was passed during the reign of Henry VIII.<sup>202</sup> Reference is also made to the Act that was passed in 1570<sup>203</sup> during the reign of Queen Elizabeth I, an Act which remained in force until the time of the American Revolution.<sup>204</sup> At this time the bankruptcy laws were strictly creditor-driven procedures, and a discharge for the debtor was not provided for.<sup>205</sup> In addition, the bankruptcy laws only applied to merchant debtors or traders.<sup>206</sup> If the debtor had committed an act of bankruptcy the creditors could petition the

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<sup>198</sup> United States Constitution, art 1 s 8 cl 4. See Dalhuisen par 3.09[1] 1-94; Herbert 49.

<sup>199</sup> Tabb 6-7; Dalhuisen par 3.09[1] 1-94.

<sup>200</sup> Tabb 7.

<sup>201</sup> 34 & 35 Hen 8 c 4 (1542-1543)

<sup>202</sup> Tabb 7.

<sup>203</sup> 13 Eliz c 7 (1570).

<sup>204</sup> Tabb 8.

<sup>205</sup> Tabb 8.

<sup>206</sup> Tabb 9.

Lord Chancellor in order to convene a bankruptcy proceeding.<sup>207</sup> The Chancellor would in turn appoint bankruptcy commissioners to supervise the process of seizing and selling the debtor's assets.<sup>208</sup> If the debtor was a non-merchant, there were separate insolvency laws that applied and that made provision for release from prison and a relief from debt in certain circumstances.<sup>209</sup>

The next two centuries saw sporadic amendments<sup>210</sup> to the bankruptcy laws, the amendments in many cases seeking to strengthen the powers of commissioners to make the bankruptcy laws more effective.<sup>211</sup> In 1705 the Statute of Anne<sup>212</sup> was passed, marking the completion of English bankruptcy law of this era.<sup>213</sup> The 1705 statute was noteworthy as it introduced a discharge of debts for co-operative debtors.<sup>214</sup> Although the statute remained of a semi-criminal nature, the foundation was laid for a more humane approach to honest debtors who had suffered misfortune.<sup>215</sup> At this time the bankruptcy laws were still very much creditor-orientated, and the discharge that was provided for was introduced more as a measure to assist creditors than as a measure to assist defaulting debtors.<sup>216</sup> Also, a discharge was not an automatic entitlement as the commissioners had to certify that the debtor had in fact been co-operative.<sup>217</sup> In 1706 creditor

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<sup>207</sup> Tabb 8.

<sup>208</sup> Tabb 8.

<sup>209</sup> Tabb 9.

<sup>210</sup> For a list of these amendments, see Tabb 10 fn 30.

<sup>211</sup> Tabb 10.

<sup>212</sup> 4 Anne c 17 (1705).

<sup>213</sup> Tabb 10.

<sup>214</sup> Tabb 10.

<sup>215</sup> Tabb 10.

<sup>216</sup> Tabb 11.

<sup>217</sup> Tabb 11 points out that there is a similar proviso to a discharge in s 727 of the United States Bankruptcy Code (11 USC) (hereinafter referred to as the Bankruptcy Code), in that a discharge can be denied to a debtor who has not been co-operative in the collection and distribution of the estate.

consent became a prerequisite for the granting of a discharge.<sup>218</sup> Despite the fact that the bankruptcy laws remained pro-creditor for a number of years, by the middle of the eighteenth century a more liberal approach to bankruptcy had established itself, largely due to the changing attitudes regarding credit and commerce that were brought about by the industrial revolution.<sup>219</sup> At the time of the ratification of the United States Constitution and the promulgation of the first American bankruptcy law in 1800, the 1732 Statute of George II<sup>220</sup> was the English bankruptcy law that applied.<sup>221</sup> The 1732 Statute of George II served as the model for the United States 1800 Act,<sup>222</sup> retaining many of its attributes such as a discharge for co-operative debtors.<sup>223</sup>

During the colonial era of American history many of the states had passed comprehensive laws regulating debtor and creditor relations.<sup>224</sup> However, these laws were varied in their ambit and application and because the Articles of Confederation made no provision for federal bankruptcy legislation, state regulation of these issues continued.<sup>225</sup> Due to the problems that could be experienced in the field of commerce and by non-resident creditors, it was felt that bankruptcy legislation should be a subject of federal legislation.<sup>226</sup> Consequently a bankruptcy clause was added to the proceedings of the Constitutional Convention, although very little debate accompanied its inclusion.<sup>227</sup> However, for more than a century the bankruptcy clause in the

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<sup>218</sup> Tabb 11.

<sup>219</sup> Tabb 11.

<sup>220</sup> 5 Geo 2 c 30 (1732).

<sup>221</sup> Tabb 12.

<sup>222</sup> Dalhuisen par 3.09[1] 1-94.

<sup>223</sup> Tabb 12.

<sup>224</sup> Tabb 12.

<sup>225</sup> Tabb 12-13.

<sup>226</sup> Tabb 13.

<sup>227</sup> Tabb 13.

Constitution remained largely unexercised by the United States Congress. Tabb<sup>228</sup> points out that federal bankruptcy laws were only in existence between 1800 to 1803,<sup>229</sup> from 1841 to 1843<sup>230</sup> and from 1867 to 1878,<sup>231</sup> the first permanent federal bankruptcy legislation only coming into effect in 1898.<sup>232</sup>

On 4 April 1800 the first permanent federal bankruptcy law was passed,<sup>233</sup> and was to a large extent modelled on the 1732 Statute of George II.<sup>234</sup> The statute also had many of the features of the Pennsylvania bankruptcy statute that applied at the time.<sup>235</sup> The statute could still only be used by creditors and it only applied to merchants, but a discharge for co-operative debtors was permitted under the Act.<sup>236</sup> Although the Act was only intended to operate for five years, it was repealed after only three,<sup>237</sup> the main reason being small dividends and abuse of the system by unscrupulous debtors.<sup>238</sup> After the repeal of the Bankruptcy Act of 1800, the states themselves regulated relations between debtors and creditors, although two decisions of the United States Supreme Court did make life difficult for debtors. The first case, namely *Sturges v*

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<sup>228</sup> Tabb 13.

<sup>229</sup> Bankruptcy Act of 1800 c 19 2 Stat 19 (repealed by Act of Dec 19 1803 c 6 2 Stat 248).

<sup>230</sup> Bankruptcy Act of 1841 c 9 5 Stat 440 (repealed by Act of Mar 3 1843 c 82 5 Stat 614).

<sup>231</sup> Bankruptcy Act of 1867 c 176 14 Stat 517 (repealed by Act of June 7 1878 c 160 20 Stat).

<sup>232</sup> Tabb 14 points out that each federal law was passed as a result of some or other major financial disaster, following the Panic of 1797, the Panic of 1837 and the Panic of 1857 and the Civil War respectively. The 1898 Act was passed after the Panic of 1893. See also Kennedy and Clift 170-171; Skeel 323; Herbert 49.

<sup>233</sup> Bankruptcy Act of 1800 (c 19 2 Stat 19).

<sup>234</sup> Tabb 14; Kennedy and Clift 171.

<sup>235</sup> Tabb 14; Kennedy and Clift 171.

<sup>236</sup> Tabb 14-15.

<sup>237</sup> Tabb 14; Kennedy and Clift 171.

<sup>238</sup> Tabb 15; Kennedy and Clift 171.

*Crowninshield*,<sup>239</sup> held that states could not constitutionally discharge pre-existing debts. In the second case, namely *Ogden v Saunders*,<sup>240</sup> the court held that states could discharge future debts against citizens of the same state, but not against citizens of another state.<sup>241</sup>

The Bankruptcy Act of 1841<sup>242</sup> was eventually passed as a result of numerous factors, not least due to the Panic of 1837.<sup>243</sup> This Act also followed numerous attempts to introduce bankruptcy legislation that provided for both voluntary and involuntary bankruptcy.<sup>244</sup> This was eventually achieved in the Bankruptcy Act of 1841, but the Act did not apply to corporations.<sup>245</sup> However, this Act too was not successful from the viewpoint of creditors as they received small dividends and faced high administration expenses.<sup>246</sup> Consequently the Act was repealed a little more than a year after it had come into operation.<sup>247</sup> Despite its repeal, the Act had entrenched some important principles that would never again be questioned, namely the use of voluntary proceedings by debtors and the marriage of the concepts of insolvency and bankruptcy.<sup>248</sup>

The Panic of 1857 and the financial crisis caused by the American Civil War, led to the enactment of the Bankruptcy Act of 1867.<sup>249</sup> The only major differences between the 1841 Act and the 1867

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<sup>239</sup> 17 US (4 Wheat) 122 (1819).

<sup>240</sup> 25 US (12 Wheat) 213 (1827).

<sup>241</sup> Tabb 15.

<sup>242</sup> C 9 5 Stat 440.

<sup>243</sup> Tabb 16; Kennedy and Clift 171; Dalhuisen par 3.09[1] 1-94.

<sup>244</sup> Tabb 16; Kennedy and Clift 171. For other important features of this Act see Kennedy and Clift 171-172.

<sup>245</sup> Tabb 16-17.

<sup>246</sup> Tabb 18.

<sup>247</sup> Tabb 18; Dalhuisen par 3.09[1] 1-94.

<sup>248</sup> Tabb 18. Tabb refers to the 1841 Act as “the first modern bankruptcy law”. See also Kennedy and Clift 171-172; Dalhuisen par 3.09[1] 1-94.

<sup>249</sup> C 176 14 Stat 517. See also Dalhuisen par 3.09[1] 1-94–1-95.

Act was the fact that it now also applied to corporations, the restriction of involuntary bankruptcy to merchants was dropped and the list of the acts of bankruptcy was extended.<sup>250</sup> This Act also started to shape the current system used by the United States in regard to the judicial mechanisms that were used for dealing with bankruptcy cases.<sup>251</sup> The criticisms against this Act were the same as against the previous Acts, and consequently the Act was repealed in 1878.<sup>252</sup> At the time the 1867 Act found application, a new innovation in the form of a composition agreement had been introduced into bankruptcy legislation in 1874.<sup>253</sup> This was the forerunner of modern re-organisation provisions and was quite advanced in its application.<sup>254</sup>

An important turn of events in American bankruptcy history was the introduction of equity receiverships that emanated from the financial woes of the railroad companies.<sup>255</sup> Due to the repeal of federal bankruptcy law (and consequently also the compositions that were introduced in 1874), there were no mechanisms in place to assist the ailing railroad companies which were of strategic economic importance at the time.<sup>256</sup> State remedies were of no assistance due to the interstate nature of the railroads.<sup>257</sup> In order to assist the railroads, the power of the federal courts was used to supervise their restructuring, thereby ensuring their continued important role in the

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<sup>250</sup> Tabb 19; Kennedy and Clift 172; Dalhuisen par 3.09[1] 1-94.

<sup>251</sup> Tabb 19.

<sup>252</sup> Tabb 19. However, there were some positive aspects to flow from this Act. See Tabb 20-21 for a discussion of especially the state exemption laws that applied at the time. See also Dalhuisen par 3.09[1] 1-95.

<sup>253</sup> This innovation was introduced by the Act of June 22 1874 c 390 ss 17 18 Stat 178 182-184 and was repealed in 1878. See Kennedy and Clift 173; Dalhuisen par 3.09[1] 1-95.

<sup>254</sup> Tabb 21. For a brief discussion of how the composition worked and what it provided for, see Tabb 21. Of special note here is the fact that the composition was held to fall under the subject of bankruptcy. See also Kennedy and Clift 173 for a discussion of these compositions.

<sup>255</sup> Tabb 21.

<sup>256</sup> Tabb 21; see also Dalhuisen par 3.09[4] 1-99–1-100.

<sup>257</sup> Tabb 21-22.

economy.<sup>258</sup> These court-supervised receiverships remained in place until federal reorganisation laws were enacted nearly half a century later.<sup>259</sup>

The next important phase in American bankruptcy history was the enactment of the Bankruptcy Act of 1898<sup>260</sup> and its subsequent amendments.<sup>261</sup> This Act remained in force for eighty years, being repealed by America's current bankruptcy legislation, namely the Bankruptcy Reform Act of 1978.<sup>262</sup> The 1898 Act also signalled the beginning of the era of permanent federal bankruptcy legislation.<sup>263</sup> In passing the legislation through Congress there were many important aspects that needed to be considered, *inter alia* whether the legislation should be of a permanent or temporary nature and whether it should be used by creditors and debtors or only by debtors.<sup>264</sup> Ultimately the 1898 Act ushered in the modern area of liberal debtor treatment in the United States,<sup>265</sup> although much of the Act was aimed at ensuring an equitable division of the debtor's assets amongst the creditors and not at debtor relief.<sup>266</sup> The Act itself regulated some very important aspects: the Supreme Court was vested with the power to prescribe rules, forms and orders for

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<sup>258</sup> Tabb 22.

<sup>259</sup> Tabb 22. Many of the features of these receiverships are still identifiable in modern reorganisation legislation, including that of the United States. A receiver would take over the assets and run the railroad while looking for a buyer of the assets. The creditors were eventually paid out of the proceeds of a foreclosure of the assets and, since the business could be sold as a going concern, a higher price was realised and jobs were preserved (see Tabb 22). This is still one of the most important aspects of a business rescue culture - see ch 10 below and Tabb 23. In regard to receiverships during this time, see also Dalhuisen par 3.09[4] 1-99-1-100.

<sup>260</sup> C 541 30 Stat 544.

<sup>261</sup> Tabb 23-32; Kennedy and Clift 174-178. For a detailed discussion of the 1898 Bankruptcy Act, see Skeel 321-341; Tabb "Regress or Progress?" 353-381.

<sup>262</sup> Tabb 23; Herbert 49-50.

<sup>263</sup> Tabb 23. For a discussion of the most important aspects of this Act, see Kennedy and Clift 175. See also Skeel 322; Dalhuisen par 3.09[2] 1-951-98; Jackson 1.

<sup>264</sup> Tabb 23.

<sup>265</sup> For a discussion of these aspects see Tabb 24-25; Kennedy and Clift 175; Skeel 322-323.

<sup>266</sup> Tabb 25.

procedure;<sup>267</sup> creditors exercised increased control over the bankruptcy process by being allowed to elect a trustee; and federal district courts sat as courts of bankruptcy, although most of the work was done by referees who were appointed by the district courts.<sup>268</sup> These referees were eventually appointed bankruptcy judges in 1973.<sup>269</sup>

Another important aspect of the 1898 Act was that corporations were unable to make use of the voluntary bankruptcy procedure, although certain types of business corporations were subject to involuntary bankruptcy procedures.<sup>270</sup> The Act did however make provision for the bankruptcy of partnerships.<sup>271</sup> Compositions as an alternative to liquidation was re-introduced in the 1898 Act, although the procedures in order to approve the composition did differ.<sup>272</sup> Once a composition was accepted by the requisite majority, the bankruptcy case was dismissed.<sup>273</sup> Despite numerous attempts to have the 1898 Bankruptcy Act repealed, the Act survived and was subjected to numerous amendments, especially during the years of the Depression and during the presidency of Hoover.<sup>274</sup> The Depression era brought about numerous pro-debtor amendments that assisted the rehabilitation of debtors through bankruptcy.<sup>275</sup> Compositions and reorganisations became more readily available from 1933,<sup>276</sup> and corporate reorganisations were sanctioned a year

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<sup>267</sup> See also Dalhuisen par 3.09[2] 1-97–1-98.

<sup>268</sup> Tabb 25; Kennedy and Clift 175-176.

<sup>269</sup> Tabb 25.

<sup>270</sup> S 4b 30 Stat 547; Tabb 26; Kennedy and Clift 175.

<sup>271</sup> S 5 30 Stat 547; Tabb 26.

<sup>272</sup> Tabb 26; Kennedy and Clift 175; Dalhuisen par 3.09[2] 1-97.

<sup>273</sup> S 12e 30 Stat 550; Tabb 26.

<sup>274</sup> For a brief discussion of these amendments and their content, see Tabb 26-30.

<sup>275</sup> Tabb 28.

<sup>276</sup> See Dalhuisen par 3.09[5] 1-100–1-105.

later in 1934.<sup>277</sup> The next important event in the history of the United States bankruptcy laws was the so-called Chandler Act, which was passed in 1938.<sup>278</sup> The effect of the Chandler Act was to substantially review almost all of the provisions of the 1898 Act and to update the whole of the process of bankruptcy law.<sup>279</sup> The most important amendments brought about by the Chandler Act were the provisions relating to reorganisations, which were now incorporated into the Act itself.<sup>280</sup> Although many amendments were made to the 1898 Bankruptcy Act between 1938 and 1978, most were passed to address specific issues and were not of a general nature.<sup>281</sup> In 1970 the United States Congress created the Commission on the Bankruptcy Laws of the United States.<sup>282</sup> The purpose of the Commission was to study and report on the existing bankruptcy laws and when it did lodge its report in 1973, the Bankruptcy Reform Act followed five years later in 1978, replacing the 1898 Act with the current Bankruptcy Code of 1978.<sup>283</sup>

### 5 3 American bankruptcy legislation after 1978

The Bankruptcy Reform Act of 1978 represented the first major overhaul of the federal bankruptcy laws for forty years, and repealed the law that had been in operation for eighty

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<sup>277</sup> This was done by means of Act of June 7 1934 c 424 48 Stat 911, 912-925, which created s 77B of the 1898 Bankruptcy Act. See also Tabb 28; Herbert 50.

<sup>278</sup> C 575 52 Stat 840 (1938). See also Kennedy and Clift 176-177 for a discussion of the Chandler Act.

<sup>279</sup> Tabb 29; Kennedy and Clift 176; Herbert 50.

<sup>280</sup> Tabb 30; Kennedy and Clift 176. The reorganisation provisions were contained in ch X (corporate reorganisations); ch XI (arrangements); ch XII (real property arrangements); and ch XIII (wage earner plans). Kennedy and Clift, with reference to *Wright v Union Cent Life Ins Co* 311 US 273 61 S Ct 196 85 L Ed 184 (1940), point out that since 1938 there has been a Congressional policy favouring reorganisation over liquidation whenever possible. See also Dalhuisen par 3.09[5] 1-101-1-105.

<sup>281</sup> See Tabb 30-32 for a discussion of these amendments and their relevance at the time.

<sup>282</sup> Act of July 24 1970 84 Stat 468.

<sup>283</sup> Tabb 32.

years.<sup>284</sup> What made the enactment of the Bankruptcy Reform Act so significant was that it was not preceded by any of the financial calamities that had underscored previous bankruptcy legislation.<sup>285</sup> It is not intended to deal with all the reforms<sup>286</sup> brought about by the Bankruptcy Code when it came into operation on 1 October 1979.<sup>287</sup> However, the main issues that were addressed can be summarised as follows:

- (a) The status of bankruptcy judges;<sup>288</sup>
- (b) Improvement of the administration process;<sup>289</sup>
- (c) Merging of all the provisions relating to reorganisation into one chapter of the Bankruptcy Code (Chapter 11);<sup>290</sup>
- (d) Encouraged greater use of the Chapter 13 procedure relating to the adjustment of debts of individuals;<sup>291</sup> and

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<sup>284</sup> Tabb 32. For a detailed discussion of the legislative history of the Bankruptcy Reform Act, see Klee 275-297. For a discussion of the main features of the Bankruptcy Reform Act see Kennedy and Clift 178-180; Dalhuisen par 3.09[7] 1-106-1-117.

<sup>285</sup> Tabb 32; Klee 277.

<sup>286</sup> See *Report of the Commission on the Bankruptcy Laws of the United States* (1973) which preceded the Bankruptcy Reform Act of 1978.

<sup>287</sup> See also Klee 275; Herbert 51.

<sup>288</sup> Tabb 34; Klee 280; Kennedy and Clift 178-179. See also *Report of the Commission on the Bankruptcy Laws of the United States* (1973) ch 4.

<sup>289</sup> Tabb 35. See also *Report of the Commission on the Bankruptcy Laws of the United States* (1973) ch 5.

<sup>290</sup> Tabb 35. For a detailed discussion see *Report of the Commission on the Bankruptcy Laws of the United States* (1973) ch 9.

<sup>291</sup> Tabb 35-36. For a detailed discussion see *Report of the Commission on the Bankruptcy Laws of the United States* (1973) ch 6.

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- (e) A better balance was achieved between the rights of debtors and creditors in bankruptcy proceedings.<sup>292</sup>

There have been various amendments to the Bankruptcy Code since its inception in 1979.<sup>293</sup> These amendments were sparked by various occurrences, for example responses by Congress to decisions of the United States Supreme Court and the lower courts, initiatives by the credit industry to tighten the laws relating to debtors, and the farm crisis of the early 1980s. The most important of these post-1978 reforms was undoubtedly the Bankruptcy Reform Act of 1994.<sup>294</sup> Tabb<sup>295</sup> summarises the most important aspects of this reform Act as follows:

- (a) The creation of a second National Bankruptcy Review Commission;<sup>296</sup>
- (b) The unprecedented number of amendments to the Bankruptcy Code by Congress; and
- (c) The failure to introduce the Chapter 10 procedure for the reorganisation of small business debtors.<sup>297</sup>

#### 5 4 Is United States bankruptcy law truly unified?

Having discussed the legislative history of the United States' bankruptcy laws, the question that may now be asked is whether the Bankruptcy Code is a truly unified insolvency statute. This

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<sup>292</sup> Tabb 36.

<sup>293</sup> For a brief discussion of these amendments and the reasons therefore, see Tab 37-43; Kennedy and Clift 180-182.

<sup>294</sup> 108 Stat 4106. See also *Reforming the Bankruptcy Code* The National Bankruptcy Conference's Code Review Project Final Report (1 May 1994).

<sup>295</sup> Tabb 42-43.

<sup>296</sup> See also Kennedy and Clift 181; Herbert 53.

<sup>297</sup> See also Kennedy and Clift 182.

question may appear to be superfluous in the context of what has already been said about the all-encompassing ambit of the Bankruptcy Code. However, this question is addressed by Tabb who states:<sup>298</sup>

“‘Uniformity’ is problematic in the bankruptcy context because: (i) most laws governing the substance of relationships between debtor and creditors are *state* laws; (ii) these state laws are incorporated into and applied in the federal Bankruptcy Code; and (iii) these state laws are not necessarily uniform. Since debtors and creditors in similar factual situations will often receive different treatment in bankruptcy from state to state, one might conclude that constitutional uniformity is not achieved by the bankruptcy law.”<sup>299</sup>

Tabb reaches the conclusion that the varying state laws do not destroy the uniformity of bankruptcy law in the United States. In doing so he refers to the United States Supreme Court decision in *Hanover National Bank v Moyses*<sup>300</sup> where it was held that the United States Constitution requires geographical uniformity as opposed to personal uniformity.<sup>301</sup> Although Tabb refers to “uniformity” in the constitutional sense of the word in the United States, he nevertheless states the following regarding such uniformity:

“Thus, a bankruptcy law is ‘uniform’ when (i) the substantive law applied in a bankruptcy case conforms to that applied outside of bankruptcy under state law; (ii) the same law is applied to all debtors within a state and to their creditors; and (iii) Congress uniformly delegates to the states the power to fix those laws.”

Consequently the United States’ bankruptcy laws are seen to be “uniform”, especially when reference is made to the federal system of government that is employed in America. South Africa does not have a similar problem as we do not have a federal system of government.

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<sup>298</sup> Tabb 46.

<sup>299</sup> As is the case in Australia (see par 3 above), this is also a constitutional issue and not one based on insolvency considerations.

<sup>300</sup> 186 US 181 (1902).

<sup>301</sup> See Tabb 46-47. The uniformity or not of state laws is referred to as personal uniformity - see Tabb 46. For a detailed discussion of the United States exemption laws (which are regulated by the states themselves) see Dalhuisen par 3.09[6] 1-105-1-106.

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## 5 5 Conclusion

From what has been stated above it is evident that early American bankruptcy laws were based on the English statutes of the time. As the American economic, social and political system progressed, legislation was designed around the specific needs of the population.<sup>302</sup> This saw a divergence from English law as early as the mid-nineteenth century.<sup>303</sup> Although the first federal bankruptcy legislation that was passed under the United States Constitution was to a large extent modelled on English law, this was the beginning of an even bigger divergence from the conservative pro-creditor bankruptcy laws that still applied in England.<sup>304</sup>

As is the case in many countries, the United States' bankruptcy laws were usually only amended or enforced at federal level when some or other financial calamity had struck the American nation. It was only in the late nineteenth century that bankruptcy law became entrenched at federal level. But from that point onward, and it is submitted to a large extent due to the success of the reorganisation provisions contained in the 1898 Act, federal bankruptcy laws have remained permanent. At the present time the Bankruptcy Code has become entrenched, reflecting the importance that Americans attach to this dynamic field of the law.

Dalhuisen,<sup>305</sup> with reference to Riesenfeld, states that “[a] ‘progressing liberalization’ has given the United States bankruptcy policy three primary purposes”. These three primary purposes are stated as being:

- (a) To avoid the pitfalls (“evils”) of liquidation;

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<sup>302</sup> For an insightful discussion of the events that led to the enactment of the 1898 Bankruptcy Act and its divergence from English Law, see Skeel 321-341, especially at 340-341.

<sup>303</sup> See Tabb 16; Skeel 340-341.

<sup>304</sup> See Skeel 327-328.

<sup>305</sup> Dalhuisen par 3.09[7] 1-106–1-107.

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- (b) To relieve the honest debtor from the indebtedness and to provide a fresh start unhampered by pre-existing debt; and
- (c) To ensure an effective and speedy administration of bankrupt estates.

Although this “progressive liberalization” has caused America to move from being a pro-creditor insolvency jurisdiction to becoming a liberal pro-debtor system, nothing ever seems to be cast in stone in the United States. American bankruptcy law can best be described as a dynamic field of the law, ever-changing to meet the needs of the society it serves. This is again reflected in the recent call by credit card companies to tighten the laws relating to a discharge of the debtors that abuse the easy flow of credit from these organisations.<sup>306</sup> Although the United States Bankruptcy Code is a uniform insolvency statute in the true sense of the word, it is submitted that its precise mechanics cannot easily be imported into a country that does not make use of a federal system of government and a federal court system.<sup>307</sup> The Americans have designed their bankruptcy laws around the uniqueness of their socio-economic and political system, and while the effectiveness of their system is to be lauded, it cannot be implemented in its precise form by a country which has only a developing economy.<sup>308</sup> It is for this reason that the content and precise mechanics of the American system is of limited use to South Africa in designing a uniform insolvency Act.<sup>309</sup>

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<sup>306</sup> Tabb “Regress or Progress?” 345.

<sup>307</sup> Skeel 341.

<sup>308</sup> In this regard see Braucher “Harmonizing the Business Bankruptcy Systems of Developed and Developing Nations: Some Issues” 1997 17 *New York Law School Journal of International and Comparative Law* 473-480. Braucher states that a country’s bankruptcy reorganisation system should be viewed as part of its law and policy of economic development, but that this does not necessarily mean that a country’s stage of development is or should be the predominant concern when designing a business bankruptcy system.

<sup>309</sup> It must also be borne in mind that South Africa has elected to retain a relatively conservative pro-creditor system (see part 4 below), which is in conflict with the liberal pro-debtor bankruptcy laws of the United States. Until such time as South Africa has a more liberal system, the bankruptcy laws of the United States will be of limited value in this regard.

Apart from exposing the South African insolvency system's weaknesses as a pro-creditor system, there are also some other lessons to be learnt from the American experience, namely:

- (a) It is in fact possible to bring about an insolvency statute that applies to all debtors. The United States Bankruptcy Code has succeeded in bringing about a single statute dealing with all aspects of insolvency.<sup>310</sup>
- (b) The United States Bankruptcy Code is a fine example of assembling all the relevant aspects of insolvency law under one statute. Not only does the code deal with straight liquidation, but it also has numerous chapters dealing with business rescue and the reorganisation of consumer debt.
- (c) The United States Bankruptcy Code is also an example of how insolvency as a separate legal discipline can evolve. From its humble origins in English law, it has developed into federal legislation that is both liberal and pro-debtor; quite a turn-around from the pro-creditor system it originated from.
- (d) Finally, the United States Bankruptcy Code is a good example of how insolvency can be arranged within a single statute in order to promote the harmonisation of the bankruptcy laws. The arrangement within the Code itself into different chapters, while at the same time leaving spaces open for the introduction of new concepts, can serve as a useful template on which other jurisdictions can model their own insolvency laws.

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<sup>310</sup> Eg, not only does the Bankruptcy Code deal with straight liquidation, but it also deals with business rescue and the reorganisation of consumer debt.