Global Restructuring & Insolvency Guide

South Africa

Overview and Introduction

South African insolvency law regulates three main types of insolvency proceedings, namely the sequestration of personal estates, the winding-up of companies and the winding-up of close corporations. Furthermore, the law regulates proceedings which are aimed at rescuing businesses in dire financial straits. This Guide provides a general overview of the insolvency regime in South Africa, specifically in relation to companies; a brief overview of the position of cross-border insolvency in South Africa; as well as an examination of the new corporate restructuring provisions relating to business rescue proceedings.

Applicable Legislation

The insolvency regime in South Africa is governed by three statutes, the application of which depends on the type of insolvency proceedings in issue. The sequestration of a natural person's estate is governed by the Insolvency Act 24 of 1936 (the "**Insolvency Act**"), whilst the winding-up of close corporations is regulated by the Close Corporations Act 69 of 1984 (the "**Close Corporation Act**"). The law regulating the winding-up of companies (both public and private) is contained chiefly in the Companies Act 61 of 1973 (the "**Old Companies Act**") (which, pursuant to the provisions of item 9 of Schedule 5 of the Companies Act 71 of 2008 (the "**New Companies Act**"), remains in force under the new company law regime) as read with the laws relating to insolvency insofar as they are applicable. Only companies that are "insolvent" may be wound up in terms of the provisions of the Old Companies Act, whereas "solvent" companies must be wound up in terms of the New Companies Act.

As part of the transition to the new company law regime, the New Companies Act stipulates that no new close corporations may be incorporated from the date of promulgation. Furthermore, all existing close corporations were afforded an opportunity to convert to a private company with minimal administrative and financial expense. The legislation is therefore a clear indication of South Africa's desire to move away from the use of close corporations as juristic trading entities. It is for this reason that a discussion of the insolvency laws relating to close corporations has been omitted from this Guide; however, it should be noted that the provisions in the Close Corporation Act relating to the winding-up of close corporations effectively incorporate many of the provisions of the Old Companies Act and simply make these provisions applicable to close corporations.

In relation to the international aspects of restructuring and insolvency law in South Africa, the common law of cross-border insolvency is currently applicable with respect to the recognition in South Africa of representatives appointed in formal insolvency proceedings instituted overseas. The Cross-Border Insolvency Act 42 of 2000 (the "**Cross-Border Insolvency Act**"), once in operation, will govern much of the law relating to such recognition.

The Test for Insolvency; Grounds for a Winding-up

A person or entity is generally considered to be insolvent when he or it is unable to pay his/its debts; however, the legal test of insolvency under South African law is whether a debtor's liabilities, fairly estimated, exceed the debtor's assets, fairly valued. An inability to pay debts is therefore, at most, merely evidence of insolvency.

Apart from the test of insolvency, section 344 of the Old Companies Act sets out the eight grounds on which a court may wind up a company, the details of which appear below.

Special Resolution

The court may wind up a company if it has passed a special resolution (i.e. by 75% of the general meeting of members) to be wound up by the court.

Premature Commencement of Business

The court may wind up a company if it has commenced business before the Registrar has issued a certificate.

Failure to Commence or Continue with Business

The court may wind up a company if it has not commenced its business within a year of its incorporation, or if the company has suspended its business for a whole year.

Public Company's Members Fewer than Seven

A public company is required to have at least seven members and may be wound up by a court if the number drops below seven.

Loss of Capital

The court may wind up a company if 75% of its issued share capital has been lost or becomes useless for its business.

Inability to Pay Debts

The court may wind up a company if it is unable to pay its debts. A company will be deemed to be unable to pay its debts in each of the following circumstances:

- A creditor to whom the company is indebted in a sum not less than ZAR 100 has served a demand on the company demanding payment and the company has neglected to pay the sum for three weeks thereafter;
- A warrant of execution (or other process) issued on a judgment against the company has been returned by the sheriff with an endorsement that he did not find disposable property sufficient to satisfy the judgment, or that the disposable property found and sold did not satisfy the process; or
- It is proved to the satisfaction of the court that the company is unable to pay its debts.

Dissolution of External Company

The court may wind up an external company if it has been dissolved in the country in which it was incorporated, has ceased to carry on business, or is carrying on business only for the purpose of winding up its affairs.

Just and Equitable

In addition to the seven specific grounds for winding-up listed above, the court may wind up a company if it appears that it is just and equitable that the company should be wound up. The courts do not consider this ground to be a limitless "catch-all" clause and have resorted to winding up companies under this ground only in limited instances, for example, where the main object for which the company was formed is not possible of being attained; where the company's objects are illegal or the company was formed to defraud the persons invited to subscribe for its shares; where the minority shareholders are oppressed by the controlling shareholders; and where there is a justifiable lack of confidence in the conduct and management of the company's affairs.

Classes of Creditors – A Brief Summary

The broad categories of priorities attaching to creditor claims in insolvency cases in South Africa are comparable to the classes of creditors in England and Wales. In general terms, there are three types of creditors whose claims rank differently depending on a number of factors.

A secured creditor is in the strongest position in a liquidation, as a secured claim is one in respect of which the creditor holds security, i.e. has a preferent right over property of the insolvent estate by virtue of a landlord's legal hypothec, a pledge, a right of retention or a special mortgage. In this context, a preferent right to payment means a right to payment "out of" the property in preference to other claims. Accordingly, the creditor has a right to be paid first out of the proceeds of the realisation of the secured property.

If, in terms of the Insolvency Act, a right to payment "out of" the property of the estate is enforceable before other creditors' rights, but is not secured, the preferent creditor's claim ranks for payment out of the free residue before the claims of the concurrent creditors. For example, the bondholder under a general notarial bond holds a preferent claim but is not a secured creditor.

Finally, a concurrent claim is one which is neither secured nor preferent in terms of the Insolvency Act, and it ranks behind both secured and preferent claims.

Business Rescue Proceedings

Prior to the enactment of the New Companies Act, the primary corporate rescue mechanism in South Africa was that of judicial management, as contained in the Old Companies Act. This, however, was a largely unsuccessful mechanism and has been effectively replaced by a new corporate rescue procedure, business rescue, as contained in Chapter 6 of the New Companies Act, which came into operation on 1 May 2011.

Although corporate rescue is categorised as an insolvency procedure, a policy decision was made to include it in the New Companies Act instead of in a unified insolvency statute. Accordingly, the provisions relating to business rescue are not applicable to other forms of business enterprise such as partnerships, business trusts and sole proprietorships.

The provisions in Chapter 6 of the New Companies Act are aimed at preventing the demise of viable companies by making provision for their possible rescue. If a plan cannot be devised to rescue the company, then a plan that would ensure a better return for the company's creditors than the return which would ensue pursuant to its winding-up is the next objective. If this is not possible, then the company ought to be wound up. In practice, it is observed that business rescue is not always a viable option to prevent the liquidation of a company, as the success of the business rescue proceedings relies substantially on whether there is sufficient financing available and whether the problem that caused the financial straits can be extricated from the business. In some cases, even the nature of the business itself is a significant factor in the prospects of success.

Initiation of Business Rescue Proceedings

There are two ways in which business rescue proceedings may be commenced. The first way is by resolution of the board of directors, and the second is upon application to the court by an affected person.

Section 129(1) of the New Companies Act provides that the board of directors of a company may take a formal decision by majority vote to commence business rescue proceedings, provided the board has reasonable grounds to believe that the company is financially distressed and there appears to be a reasonable prospect of rescuing the company. This general power of the board of directors is, however, qualified by section 129(2)(a) of the New Companies Act, which provides that the board of directors may not adopt a resolution to commence business rescue proceedings if steps to liquidate the company have already been "initiated", i.e. if an application for the liquidation of the company has been put before the court.

The second manner in which business rescue proceedings may be commenced is in terms of section 131(1) of the New Companies Act, where an affected person applies to court for an order placing the company under supervision and commencing business rescue proceedings. An "affected person" in the context of business rescue proceedings includes shareholders, creditors, registered trade unions representing the company's employees and the individual employees themselves. In such a circumstance, the affected person would have to satisfy the court either that the company is financially distressed or has failed to pay any amount due in respect of its employees, or that it is otherwise just and equitable to commence the proceedings for financial reasons and there is a reasonable prospect of rescuing the company. The Supreme Court of Appeal recently confirmed that such an application can be brought even after an order for the winding-up of a company has been granted.

In this regard, a company would be "financially distressed" if it appears to be commercially insolvent (i.e. reasonably unlikely to be able to pay all its debts as and when they fall due within the succeeding six months) or is reasonably likely to become insolvent (i.e. its liabilities are reasonably likely to exceed its assets within the succeeding six months).

In the case of voluntary commencement, within five days after the commencement of the business rescue proceedings, the company must publish in the prescribed manner a notice of the resolution and its effective date, as well as a sworn statement of the facts relevant to the grounds on which the board's resolution was founded. Notice must be given in the prescribed manner, i.e. by delivering a copy to each and every affected person, displaying a copy at the registered office of the company, publishing a copy on any website maintained by the company, and if it is a listed company, on any electronic system maintained by the exchange for the communication of information by and among companies listed on the exchange.

Furthermore, within the same time (i.e. five days of commencement), the company must appoint a suitably qualified business rescue practitioner, who must consent to the appointment in writing, and file a notice of appointment with the Companies and Intellectual Property Commission. The notice must also be published to all affected persons in the prescribed manner or by informing each affected person of the availability of a copy of the notice.

Due to the fact that the initiation of a voluntary business rescue proceeding by a company is open to potential abuse, an affected person may approach the court in appropriate circumstances to request an order setting aside the business rescue resolution adopted by the board, setting aside the appointment of the business rescue practitioner, or requiring the appointed business rescue practitioner to provide security (section 130 of the New Companies Act).

In the case of compulsory initiation of business rescue proceedings by an affected person under section 131 of the New Companies Act, the business rescue proceedings commence at the time the application is made to court.

Moratorium and Property Interests

For the duration of the business rescue proceedings, there is a general moratorium on legal proceedings, including any enforcement action, against a company or in relation to any property belonging to the company or lawfully in its possession. Although there is no definition of the terms "legal proceedings" or "enforcement action", the intention of the legislature was to cast the net as wide as possible to include every conceivable type of action against the company (section 133 of the New Companies Act). The aforesaid intention was highlighted in a recent Supreme Court of Appeal decision where the court held that the phrase "legal proceeding" includes arbitration proceedings.

Furthermore, section 134 of the New Companies Act provides that the disposal of company property during the business rescue proceedings may only be done in circumstances where it is required for the normal operation of the business, or as part of a business rescue plan. Disposals of company property may also occur in a *bona fide* arm's length transaction for fair value, approved in advance and in writing by the business rescue practitioner.

Effect on Employees and Contracts

The protection of employees during the business rescue process is of high regard, and the employees continue to be employed throughout the proceedings on the same terms and conditions that applied prior to the commencement of the business rescue proceedings. Any planned retrenchment is still subject to sections 189 and 189A of the Labour Relations Act 66 of 1995, as well as any other employment-related legislation.

On the other hand, contracts other than employment contracts may be suspended (entirely, partially or conditionally) by the business rescue practitioner for the duration of the business rescue proceedings. The business rescue practitioner may also apply urgently to a court to cancel (entirely, partially or conditionally), on any terms that are just and reasonable in the circumstances, any obligation of the company in terms of that contract. In such circumstances, the only remedy of an aggrieved contracting party is to claim damages from the company.

Participation of Creditors, Employees, Shareholders and the Directors of the Company – Generally

In addition to enjoying rights as an affected person (e.g. the right to be notified), each creditor is entitled to formally participate in legal proceedings relating to the business rescue proceedings, to form a creditors' committee, to be consulted by the business rescue practitioner during the development of a business rescue plan, and to vote on the business rescue plan. Creditors are also entitled to participate in the development of a business rescue plan on a more informal level by making proposals for a business rescue plan to the practitioner.

Employees have similar rights to participate in legal proceedings relating to the business rescue proceedings, to form a committee of employees' representatives and to be consulted by the business rescue practitioner during the development of a business rescue plan.

Shareholders are affected persons in terms of the New Companies Act and therefore have the rights bestowed upon affected persons. Furthermore, shareholders have a right to participate in legal proceedings but may vote on the business rescue plan only if the adoption and implementation of the plan would alter the rights associated with the class of securities held by that shareholder.

During a company's business rescue proceedings, each director of that company must continue to exercise the functions of a director, subject to the authority of the business rescue practitioner, and remains bound by the duties and obligations which existed prior to the commencement of the business rescue proceedings. In addition, the directors are obliged to cooperate with the business rescue practitioner and provide the business rescue practitioner with all books, records and information relating to the affairs of the company. If a director fails to comply with his duties and obligations, the business rescue practitioner may apply to court for an order removing the director from office.

Meetings and the Business Rescue Plan

Separate first meetings are held, on notice, for the creditors and the employees' representatives of the company, although in practice, these meetings are held on the same day and at the same venue, but at different times. Employees who are also creditors of the company are entitled to attend both meetings.

At the first meeting of creditors, the business rescue practitioner is obliged to inform the creditors whether or not he believes there is a reasonable prospect of rescuing the company. The business rescue practitioner may also receive proofs of claim by creditors.

At the first meeting of employees' representatives, the business rescue practitioner must similarly inform the creditors whether or not he believes there is a reasonable prospect of rescuing the company.

After consulting the creditors, employees, shareholders and management of the company, the business rescue practitioner must prepare and publish a business rescue plan for consideration and possible adoption.

Once a plan is published, a meeting to determine the future of the company is held, on notice. At this meeting, the creditors, and the holders of any issued security of the company if their rights are affected, decide whether or not to adopt the business rescue plan proposed by the business rescue practitioner. As the entire process of discussing, voting on or amending the plan has the potential to be long and convoluted, this meeting may be adjourned from time to time.

If the business rescue plan is approved at the meeting to determine the future of the company by a majority of the holders of more than 75% of the creditors' voting interests present at the meeting and the votes in support of the proposed plan include at least 50% of the independent creditors' voting interests present at the meeting, then the plan is binding on all the creditors, regardless of whether or not they were present at the meeting or how they voted.

If the business rescue plan is rejected, the business rescue practitioner may either seek a vote of approval from the holders of the voting interests to prepare and publish a revised plan, or advise the meeting that the company will apply to court to set aside the result of the vote on the grounds that it is inappropriate.

Termination of Business Rescue Proceedings

The business rescue procedure provided for is designed to last for a very brief period of only three months. Business rescue proceedings can then be terminated in the following ways:

- When the court sets aside the resolution or order commencing the proceedings;
- When the court converts the business rescue proceedings into liquidation proceedings;
- When the business rescue practitioner files a notice of the termination of business rescue proceedings;
- When a business rescue plan has been proposed and rejected and no affected person takes steps to extend the proceedings; or
- When a business rescue plan has been proposed and adopted and the business rescue practitioner files a notice of substantial implementation of that plan.

Winding-up

As stated earlier, the law regulating the winding-up of companies (both public and private) is contained mainly in the Old Companies Act which, pursuant to the provisions of item 9 of Schedule 5 of the New Companies Act, remains in force under the new company law regime, as read with the laws relating to insolvency insofar as they find application. It must be remembered, however, that only companies that are "insolvent" may be wound up in terms of the provisions of the Old Companies Act, whereas "solvent" companies must be wound up in terms of the New Companies Act.

A company may be wound up in two ways: by the court or voluntarily.

Procedure − Voluntary Winding-up

A company (other than an external company) may be wound up voluntarily if it has adopted a special resolution and that resolution has been registered by the Registrar. The special resolution will state whether the winding-up is a members' voluntary winding-up or a creditors' voluntary winding-up.

A members' voluntary winding-up may only be initiated if the company is able to pay its debts in full and is resorted to in circumstances where, for example, the purpose for which the company was formed has been fulfilled or the members responsible for running the company are no longer on amicable terms. As the company is "solvent", the provisions of the New Companies Act apply.

Conversely, a creditors' voluntary winding-up may be resorted to in circumstances where a company is unable to pay its debts. The procedure resembles that of a compulsory winding-up in that meetings of creditors are held and the liquidator is subject to the directions of the creditors who have proved claims. The directors must prepare a statement of the company's affairs and lay it before the meeting convened to pass the resolution.

Procedure − Compulsory Winding-up

Winding-up by the court (sometimes called compulsory winding-up) is initiated by an application to the High Court, accompanied by an affidavit, usually brought by a creditor. The company itself, one or more of its members and the Master of the High Court all also have the requisite *locus standi* to bring such an application, however.

Prior to bringing the application, the applicant must give sufficient security for the payment of all fees and charges necessary for the prosecution of all winding-up proceedings and of all costs of administering the company in liquidation until a provisional liquidator has been appointed or, if none is appointed, of all fees and charges necessary for the discharge of the company from the winding-up.

The applicant is also required to serve a copy of the application on the Master, who may report to the court any facts which may justify postponing or dismissing the application. Furthermore, the applicant must furnish a copy of the application to every registered trade union that represents any of the company's employees, the employees themselves, the South African Revenue Service and the company itself (unless the application is made by the company or the court dispenses with the requirement in the interests of the company or creditors thereof).

The court may grant or dismiss any application for winding-up; adjourn the hearing, conditionally or unconditionally; or make any interim order or any other order it may deem just. In practice, the court usually makes a provisional winding-up order (provided the applicant has made out a *prima facie* case), and issues a *rule nisi* calling on all interested parties to show cause on the return date why the court should not make the order final.

Consequences of Winding-up

Winding-up establishes a creditors' *concursus* which is aimed at ensuring that the company's property is collected and distributed among creditors in the prescribed order of preference. The company does not lose its corporate identity or title to its assets, but from the commencement of the winding-up, the powers of the directors cease and the directors are discharged (in a voluntary winding-up, however, the liquidator, creditors or members may sanction a continuance of directors' powers), the company's property is deemed to be in the custody and under the control of the Master until a provisional liquidator has been appointed and assumes office, and the company may not continue with its business, except insofar as it may be necessary for its beneficial winding-up.

In amplification of the above, after the winding-up of a company has commenced, any transfer of shares of the company without the liquidator's permission is void, and if the company is unable to pay its debts, every disposition of its property (including rights of action) not sanctioned by the court is similarly void. Furthermore, no set-off can take place unless mutuality of the respective claims existed at the time of the winding-up.

Furthermore, all civil proceedings, including judgments, by or against the company are suspended from the time the winding-up order is made or a special resolution for the voluntary winding-up is registered until the appointment of a liquidator or liquidators, as the case may be, by the Master.

Meetings and Proofs of Claim

Following the granting of a winding-up order, be it voluntary or a compulsory winding-up, at least two creditors' meetings must be held. The purposes of the meetings are to allow creditors to consider the company's statement of affairs, prove claims and, in the case of the first meeting, nominate a liquidator as well as provide him with suitable directions and authority on dealing with assets, claims against the estate and related matters. The directors and officers of the company are obliged to attend these meetings.

In regard to the proof of claims, section 366(2) of the Old Companies Act provides that the Master of the High Court may fix a time or times within which creditors of the company are to prove their claims or otherwise be excluded from the benefit of any distribution under any account lodged with the Master before those claims are proved. Usually, claims will be proven at either the first or second meeting of creditors, on a date as provided for by the liquidator.

A members' meeting must be held in a winding-up by the court and in a creditors' voluntary winding-up. The purpose of this meeting is to allow the members to consider the company's statement of affairs and nominate a liquidator; however, if these issues were dealt with at the time the resolution commencing winding-up was taken, this meeting may be dispensed with.

Liquidation and Distribution Account and Distribution of Assets

The liquidator's primary duty is to take possession of all the movable and immovable property of the company, realise this property in the prescribed manner, apply the proceeds towards payment of the costs of the winding-up and the claims of creditors, and distribute the balance among the members. The liquidator stands in a fiduciary relationship to the company, to the body of its members as a whole, and to the body of its creditors as a whole.

Within six months of his appointment, a liquidator must prepare and lodge with the Master a liquidation and distribution account or, if necessary, a liquidation and contribution account that details all assets of and claims against the company. Once the account has been confirmed, the liquidator must distribute the estate or collect contributions in accordance with the account. Any assets remaining after payment of costs and creditors must be distributed among the members according to their rights and interests in the company.

Clawback and Recovery

In addition to being vested with the property of the company, the liquidator has the means of recovering certain property alienated by the company before its winding-up. The liquidator may ask the court to set aside certain dispositions made by the company before the winding-up.

As set out above, the laws of personal insolvency apply in the winding-up of a company unable to pay its debts, through express incorporation in the Old Companies Act, in respect of any matter not specifically provided for in the Old Companies Act. In particular, the Old Companies Act provides that a disposition made by a company of its property which, if made by an individual could be set aside in the event of his insolvency, may be set aside in the event of the company being wound up and unable to pay all its debts. The circumstances in which dispositions may be set aside are therefore contained in the Insolvency Act or common law, as the case may be, and are each discussed in turn below.

Dispositions Made Not for Value

In terms of section 26(1) of the Insolvency Act, as read with the Old Companies Act, a disposition made not for value can be set aside by the liquidator if he can prove that:

- The company made the disposition;
- The disposition was made no more than two years prior to liquidation (unless the liquidator can also prove that immediately after the disposition was made, the liabilities of the company exceeded its assets);
- At the time when, or immediately after, the disposition was made, the company's liabilities exceeded its assets; and
- No value was received for the disposition.

It is not necessary to establish whether or not the company intended to prejudice creditors by making the disposition, as the object of this provision is simply to prevent a company on the brink of liquidation from impoverishing its estate by giving away assets without receiving any appreciable advantage in return.

Disposition Which Prefers One Creditor above Another: Voidable Preference

Section 29(1) of the Insolvency Act, as read with the Old Companies Act, provides that a court may set aside a disposition made by the company not more than six months before the liquidation proceedings commenced, if;

- The disposition had the effect of preferring one of the company's creditors above another; and
- Immediately after the disposition was made, the liabilities of the company exceeded the value of its assets.

The rationale behind this provision is that a company ought not to favour certain of its creditors prior to liquidation to the general prejudice of the creditors' *concursus*.

The disposition does not have to be made directly to the creditor. It is required that payment must merely have had the effect of preferring the creditor, as would, for example a payment made to a creditor of a creditor.

The test for whether or not a creditor has been preferred is whether the proper distribution of assets as envisaged by the Act has been compromised and a creditor has benefited more or been paid earlier than would have been the case if he had been paid a dividend in due course.

It should be noted that there is a proviso in section 29(1) that the court cannot set aside a disposition if the person in whose favour it was made proves that it was made in the ordinary course of business and that it was not intended to prefer one creditor above another. A thorough exposition of the proviso in section 29(1) is not relevant for present purposes save to say that a disposition in the ordinary course of business requires an objective enquiry regarding whether the disposition was one which would normally be entered into between solvent business persons. Furthermore, a company will not be held to have intended to prefer if it is established that, when the disposition made, liquidation was not contemplated or expected.

Disposition Intended to Prefer One Creditor: Undue Preference

Section 30 of the Insolvency Act, as read with the Old Companies Act provides that a court may set aside a disposition that was made:

- By the company at any time before the liquidation;
- With the intention of preferring one creditor above the others; and
- When the company's liabilities exceeded its assets.

This is a powerful provision, and there is no defence available to the person benefitted by the disposition.

The test for determining whether the company had the intention to prefer is whether the primary intention in making the disposition was to disturb the proper distribution of the company's assets on insolvency.

Personal Liability of Directors and Officers

Chapter XIV of the Old Companies Act, and in particular section 425 thereof as read with the Insolvency Act, provides for a number of criminal sanctions to be placed on non-compliant directors and officers. In light of the repeal of certain provisions of the Old Companies Act, the personal liability of directors is governed by the Old Companies Act, the New Companies Act and Insolvency Act.

Failure to Make or Lodge Statement of Affairs

Section 363(8) of the Old Companies Act provides that a failure to make or lodge a statement of affairs is an offence, carrying the sanction of a fine, imprisonment for a period not exceeding 12 months, or both.

Making a False Statement in Statement of Affairs

Section 214(1)(a) of the New Companies Act makes it an offence for that a person, with a fraudulent purpose, to knowingly provide false or misleading information in any circumstances in which the New Companies Act requires the person to provide information or give notice to another person. The penalty for such an offence is a fine, imprisonment for a period not exceeding 10 years, or both.

Giving False Evidence under Interrogation

A person who wilfully makes a false statement while being interrogated on oath at a meeting of creditors commits an offence, carrying the penalty provided by law for the crime of perjury, if such statement is relative to the subject on which the person is interrogated and he knows of the falsity of the statement or does not know or believe it to be true (section 139(2) of the Insolvency Act).

Concealment or Destruction of Books or Other Documents

Section 132(a) of the Insolvency Act, read with section 339 of the Old Companies Act, makes it an offence for a person to conceal or destroy the books or assets of the company or allow another person to do so. The sanction for such conduct is three years' imprisonment if it is found that the person had no intention to defraud. Furthermore, if a person is a party to the falsification of any accounting records of a company, irrespective of the intention of such person, the penalty is a fine, imprisonment for a period of 10 years, or both.

Failure to Notify Change of Address

A director or secretary of a company who changes his residential or postal address after the commencement of the winding-up of the company, but before the liquidator's final account, and does not notify the liquidator of the new address within 14 days, is liable for a fine, imprisonment for a period not exceeding six months, or both.

Offences in Relation to Examinations in Terms of Section 417 of the Old Companies Act

If a person is summoned, by a commissioner who is not a magistrate, to attend a commission of enquiry, failure to do so without sufficient cause is an offence. Where a person is summoned by the Master, in addition to the above which is an offence, each of the following acts also constitutes an offence: failure to remain in attendance without sufficient cause; refusal to be sworn or to affirm as a witness; failure to answer, without sufficient cause, fully and satisfactorily any question lawfully put to him; and failure, without sufficient cause, to produce books or papers in his custody or under his control which he was required to produce. The penalty for these offences is a fine, imprisonment for a period not exceeding 12 months, or both.

Participation in Reckless or Fraudulent Conduct of Company's Business

Section 424(1) of the Old Companies Act provides that any person who was, prior to liquidation, knowingly a party to the carrying on of business of the company recklessly, or with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct. In order to establish liability in terms of section 424, the relevant person must be guilty of intentional deceit or of reckless conduct. Reckless conduct may consist of blameworthy conduct characterised by a failure to take due care in managing the company which is detrimental to the company and others and exhibits a high degree of disregard for the standards observed by honest and diligent men of affairs. It may also be demonstrated by a similarly uncaring and careless failure to attend to the company's business, or to prevent foreseeable harm from being caused, by failing to take reasonable preventative measures against such eventualities. An offence carries the sanction of a fine, imprisonment for a period not exceeding 12 months, or both.

Section 22(1) of the New Companies Acts introduced a wider prohibition than that of section 424 of the Old Companies Act insofar as it prohibits a company from carrying on business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purposes. Section 22(2) of the New Companies Act then introduces a novel concept aimed at deterring the trading by a company in contravention of section 22(1) or in a situation where it is commercially insolvent, i.e. where it is experiencing cash flow difficulties to the extent that it is unable to pay its debts as and when they fall due. The subsection mandates the Companies Commission to issue a notice to the company to provide reasons why it should be permitted to carry on business or trade.

Cross-Border Insolvency

Cross-border insolvency deals with a sequestration or a winding-up insolvency which affects property or debts in a jurisdiction other than the one in which the relevant court order is granted. Therefore, in a cross-border insolvency, the law of insolvency and winding-up intersects with the conflict of laws (private international law). A full exposition of the law relating to cross-border insolvency is beyond the ambit of this Guide. Accordingly, what follows is a brief description of the main problems associated with cross-border insolvency, followed by a brief description of the South African common law of cross-border insolvency and the Cross-Border Insolvency Act.

The main problems presented by cross-border insolvency include the globalisation of international business, limitations on state power, lack of international instruments for dealing with cross-border insolvency law and the conflict between the universalist and territorialist approaches to cross-border insolvency law. Solutions to deal with these problems, amongst others, are outlined in the United Nations Commission on International Trade Law's "Model Law on Cross-Border Insolvency" (1997); however, this Model Law is not a treaty but simply a template which individual states are free to adopt and adapt. South African cross-border insolvency law is presently still governed by common law principles. The legislature has passed a South African version of the Model Law called the Cross-Border Insolvency Act; however, the Act will only come into effect once the Minister of Justice has designated the foreign countries to which it will apply.

South African Common Law of Cross-Border Insolvency

The common law provides that movable property is governed by the law of the natural person's domicile (*lex domicilii*). On the other hand, immovable property is governed by the law of the place where the immovable property is situated (*lex situs*), regardless of whether the person is an individual or juristic person. In terms of South African law, however, a liquidator of an external company (foreign representative) who seeks to deal with company assets located in South Africa is required to apply for recognition to the High Court of South Africa before dealing with those assets, regardless of whether the assets are movable, immovable or incorporeal.

The South African courts apply the principles of comity, convenience and equity in exercising their discretion to recognise the liquidator (foreign representative), as recognition allows him to rely on domestic South African law in carrying out his duties.

An external company registered as such in South Africa may be wound up as though independent of its related foreign company and *vice versa*. It is therefore possible that the company may be subject to simultaneous, concurrent winding-up processes; however, the discontinuation of foreign winding-up proceedings does not in itself affect the South African process as the respective liquidators deal independently with the assets and liabilities of the company in the various countries.

Cross-Border Insolvency Act

The Cross-Border Insolvency Act includes chapters on fundamental principles, access of foreign representatives and creditors to South African courts, recognition of foreign proceedings and relief, cooperation with foreign courts and foreign representatives, and concurrent proceedings. The purpose of the Cross-Border Insolvency Act is to facilitate cooperation between South African courts and foreign courts in cross-border insolvency matters. This in turn improves legal certainty for trade and investment, promotes good administration to protect creditors and other interested persons, including the debtor, protects assets and maximises their value, protects investment and saves jobs.

The Cross-Border Insolvency Act applies where a foreign court or representative asks a South African court for assistance in foreign proceedings and, conversely, where such help is requested in a foreign court in proceedings under South African law. It also applies where foreign proceedings and South African proceedings run concurrently as regards the same debtor, or where creditors or other interested foreigners ask to begin or take part in South African insolvency proceedings. The Cross-Border Insolvency Act, however, is limited in its operation to certain designated states.

When it comes into force in the international system for cooperation intended by the Model Law, the Cross-Border Insolvency Act will provide a mechanism for foreign representatives to gain access to South African proceedings and *vice versa*. Despite the limitation by designation requirements, the

Cross-Border Insolvency Act will enable South African courts and practitioners to play a positive role in cooperating with their foreign counterparts. Once the foreign representatives have gained access to the South African legal system through the utilisation of the Cross-Border Insolvency Act, they will then have to abide by the relevant South African rules, both substantively and procedurally.

Compromise Procedure (Alternative to Liquidation)

Prior to the repeal of the Old Companies Act, section 311 of the Old Companies Act, read with section 312, provided for a compromise or arrangement between a company and its creditors, or any class of creditors, even in instances where the company was being wound up.

In terms of section 155 of the New Companies Act, irrespective of whether or not the company is financially distressed as defined in section 128(1)(f), unless the company is engaged in business rescue proceedings, the board of directors of the company or, if the company is being wound up, its liquidator may propose an arrangement or a compromise of its financial obligations to all of its creditors, or to all of the members of any class of its creditors. The proposal and a notice of a meeting to consider the proposal must be delivered to all of the creditors of the company or every member of the relevant class of creditors whose name or address is known to or can be reasonably obtained by the company, and to the Companies Intellectual Property Commission.

A proposal in terms of section 155 must contain all information reasonably required to facilitate creditors in deciding whether to accept or reject the proposal.

The adoption of a proposal requires the support by a majority in number, representing at least 75% in value, of the creditors or class, as the case may be, present and voting in person or by proxy, at a meeting called for that purpose.

If a proposal is adopted, the company may apply to the court for an order approving the proposal, in which case certain procedural requirements will need to be complied with.

Having regard to the above compromise procedure, it must also be noted that where the company is able to pay its debts, an arrangement between the company and its creditors may be effected pursuant to section 389 of the 1973 Companies Act, which continues to apply pursuant to the provisions of item 9 of Schedule 5 of the 2008 Companies Act.

Conclusion

South African law of insolvency is relatively complex due to the inter-relationship between general insolvency law provisions, as applicable to natural persons, and those contained in the Insolvency Act, the Old Companies Act, and the regulation of further aspects of insolvency in the New Companies Act. The principles, however, are well entrenched and draw strongly from English law precedent in their origin and effect.

The interaction between and functioning of the High Court, the office of the Master of the High Court and the insolvency practitioners' profession, from whose ranks liquidators are appointed, is also complex and in certain respects in need of reform. That is not a subject within the scope of this Guide, however.

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