

To Dr P M Maduna, Minister for Justice and Constitutional Development

I have the honour to submit to you in terms of section 7(1) of the South African Law Commission Act, 1973 (Act 19 of 1973), for your consideration the Commission's report on the **Review of the Law of Insolvency**.

pp Mr Justice I Mahomed
Chairperson
23 February 2000

INTRODUCTION

The South African Law Commission was established by the South African Law Commission Act, 1973 (Act 19 of 1973).

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SUMMARY

For the convenience of the reader a summary of the changes proposed in the Bill appear on page 14 below. Many of the changes are technical. The following are the more substantive changes:

1. Only a person who is a member of a professional body recognised by the Minister of Justice may be appointed as liquidator (clause 53(1)(a)).
2. The discretion of the Master of the High Court to appoint a liquidator of his or her choice has been limited in cases where creditors nominate or vote for a liquidator (clauses 32, 52, 54, 55, 58 and 60).
3. Liquidators may preside at meetings unless questioning is to take place at the meeting or an interested party requests that the Master or a magistrate should preside (clause 41(3)).
4. Resolutions can be adopted at the first meeting which is now convened by the initial liquidator as soon as possible after his or her appointment and not by the Master (clause 38).
5. A creditor under a financial lease agreement is treated as a secured creditor and must prove a claim (clause 76).
6. Many of the preferent claims (for instance for taxes) are abolished in terms of clause 80.
7. In respect of dispositions before liquidation that may be set aside, wider provisions apply to associates of the insolvent than to other persons (clauses 18 and 20) and it is presumed for all dispositions, until the contrary has been proved, that a debtor's liabilities exceeded his or her assets at any time within three years before the liquidation of the estate (clause 25(2A)).
8. A cap of R200 000 has been placed on the exclusion of pension benefits from the insolvent estate (clause 15(4)) and certain extraordinary contributions to pension funds may be recovered for the benefit of creditors (clause 22).

9. Provision is made for a binding composition between a debtor and a majority of creditors without an application to declare a debtor's estate insolvent (Schedule 4).

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See Volume 2 for an index to the Bill

1 Background

1.1 The principal Act dealing with insolvency in South Africa is the Insolvency Act 24 of 1936. This Act replaced the Insolvency Act 32 of 1916 but did not amend it drastically. The 1936 Act has been amended more than 20 times, but it has never been reviewed as a whole.

1.2 Six interim reports were submitted and seven working papers were published for comments. During 1996 a draft Insolvency Bill and Explanatory Memorandum was published as Discussion Paper 66. During 1999 a further draft Insolvency Bill and Explanatory Memorandum was published as Discussion Paper 86. Numerous commentators furnished comments on the working papers and Discussion Papers 66 and 86. It is obvious that many commentators went to great trouble to submit comprehensive comments. More than 350 pages of comments were received on Discussion Paper 66 alone. The names of the commentators on Discussion Paper 66 are listed in paragraph 8 on page 24 of Discussion Paper 86 and the names of the commentators on Discussion Paper 86 are listed in paragraph 8 below. The Commission values public participation in its work and appreciates the time and trouble taken by commentators.

1.3 A project committee was appointed to assist with the investigation. The names of the members of the project committee are reflected in the introduction above. The committee held 28 meetings during the course of the investigation. The Commission expresses its appreciation for the valuable contributions made by members of the project committee.

1.4 The law of insolvency has become a dynamic part of the law. It is subject to continual change to adjust to new circumstances. This report is an important first step to modernise the law of insolvency, but is clearly not a final assessment of the subject. The project committee has recommended that a standing advisory committee on the law of insolvency should be established. A similar committee exists for company law in terms of section 18 of the Companies Act 61 of 1973. Section 92 of the Canadian Bankruptcy and Insolvency Act provides that after the expiration of three years after reforms came into force, the Act should be referred to such committee of the House of Commons, of the Senate or of both Houses of Parliament as might be designated or established for that purpose and the committee should, as soon as practicable thereafter, undertake a comprehensive review of the provisions and operation of the Act and within one year or within such further time as the House of Commons may authorize, submit a report to Parliament thereon. In the United States of America the National Bankruptcy Conference was established in 1988, ten years after a major review of federal bankruptcy law, to examine the first decade of experience under the Bankruptcy Code and a possible agenda for its reform. The Conference issued a final report in 1994. *It is recommended that consideration be*

given to establish a standing committee on the review of the insolvency law.

1.5 For ease of reference the proposed Insolvency Bill is contained in a separate volume. A summary of the changes proposed in the Bill is given in paragraph 4 below. A clause by clause explanatory memorandum at the end of this paper expounds the changes to the present law in detail.

2 Guidelines for reform

2.1 The general principles of a number of legal systems and reform proposals were considered in search of innovative solutions to the problems experienced with the law of insolvency. There are shifts in emphasis and many differences in detail in the provisions applicable in different legal systems. In the few cases where it seemed advisable, provisions were adapted for use in South Africa. With the obvious exception of countries where private enterprise is only now beginning to develop, the similarity of the general principles found in different systems of insolvency laws is surprising. Upon reflection it is clear that similar solutions are used because of similar problems experienced worldwide. There is a general need for efficient procedures to deal with assets of the insolvent estate. If liquidation ensues, a fair distribution of the proceeds of the assets must be effected as soon as possible. All systems contain measures to investigate the affairs of the insolvent and to set aside some transactions entered into to the detriment of the general body of creditors. Systems require from debtors to co-operate but afford them an opportunity for a fresh start.

2.2 The general guidelines proposed by commentators (paragraph 3 below) did not reveal any startling solutions for existing problems. According to a document by the Legal Department of the International Monetary Fund, entitled *Orderly and Effective Insolvency Procedures: Key Issues*, the overall objectives of insolvency laws are -

2.2.1 the allocation of risk among participants in a market economy in a predictable, equitable, and transparent manner; and

2.2.2 to protect and maximise value for the benefit of all interested parties and the economy in general (Chapter 2 of the document which is available on the Internet at:

www.imf.org/external/pubs/ft/orderly/index.htm).

2.3 The aim of this investigation is to balance and satisfy the needs of the different stakeholders. The major stakeholders are the commercial community in general and creditors in particular; insolvent debtors; insolvency practitioners and the government. Because of conflicting interests it is often difficult to strike a fair balance between the different interests. *Effective, speedy and fair procedures are important needs of stakeholders and formed the basis for this review.*

2.4 The value of reforms of a practical or technical nature should not be underestimated. It is in the interest of the economy and society as a whole that insolvency problems should be solved fairly and efficiently. The following example illustrates the point: a seemingly innocuous proposal that directions by creditors should be obtained early in the liquidation process is expected to have a marked effect on finalising insolvencies and limiting the time that funds are caught up in insolvent estates; especially in difficult economic times it is important that money should be available to generate growth and should not be entangled in tiresome and time consuming procedures.

2.5 The constitutionality of the Bill was considered carefully.

3 General guidelines proposed by commentators

Role of the Master and others

3.1 A commentator says because the Master of the High Court (the "Master") fulfills such an important role creditors are less interested and involved. As a result creditors do not exercise proper control over the administration of the estate and shift the responsibility to finalise the administration to the Master. Another commentator says the existing Act leans heavily on "policing" by the State. The Master's office is burdened with the duty to make many decisions with the result that creditors have perhaps become too complacent and too reliant on the Master's office to protect their interests. He suggests a move away from criminalisation and towards self-enforcement, financial incentives and civil liability; greater self-regulation under the control of creditors and easing the burden of the Master; and a move towards self-regulation of the liquidators' profession by professional bodies. Another commentator submits, with reference to overseas systems, that the Master's burden should be lightened by providing that the Master should not be intimately concerned in the appointment of liquidators and the examination of their accounts. He concludes that the Master's office functions should be reduced as far as possible.

3.2 By contrast, another commentator says standards have dropped and more and more claims are instituted against fidelity funds; professional people go insolvent; in more sophisticated Western countries the general public has better and cheaper access to legal assistance; South Africa has a largely unskilled and poor population and the Master provides an invaluable service to aggrieved creditors; without the Master to monitor the administration of estates liquidators' fraud will become rampant; the Master's office is a unique and valuable part of our Roman-Dutch heritage and a necessary protection for our people.

3.3 The implications of relying on the Master to protect the interests of creditors are illustrated by the decision of *Wilkens v Potgieter* 1996 (4) SA 936 (T). Judge Roux says that there is a clear duty on the Master to study the relevant documents and to correlate them with the draft account; only if the Master is satisfied should he or she permit an account to be advertised and to lie for inspection. (The *Wilkens* decision is discussed in paragraph 90.2 of the explanatory memorandum below.)

3.4 The Master is placed in a difficult position if on the one hand he or she is expected to become involved in the administration of the estate and on the other it is expected to act as an impartial arbitrator. It is naive to think that the Master can exercise proper control over liquidators merely by examining documents in his or her possession. Even if checking documents is an effective control measure the Master does not have the staff to do this adequately and it takes much time to attempt this while creditors wait for their money.

3.5 The Bill places more responsibilities on creditors and reduces the role of the Master, as appears from the following examples. Clause 53 limits the appointment of liquidators to members of professional bodies who maintain and enforce rules for ensuring that their members are fit and proper persons to be appointed as liquidators and meet acceptable requirements for education and practical experience and training. The Master's discretion in connection with the appointment of liquidators has been limited (see the discussion in paragraphs 32.2 to 32.9 of the explanatory memorandum). In terms of clause 41 the liquidator instead of the Master or a magistrate may preside at most meetings. Clause 87(9) of the Bill and items 3.4 and 6.1 of Schedule 1, Form D require vouchers or proved claims upon the request of the Master and not as a matter of course. The reduction of the Master's role does not exclude an investigation of so much of a liquidator's work as the Master deems necessary when complaints are received about the work of a liquidator. In terms of clause 58(2) the Master may suspend a liquidator from office while complaints or charges against a liquidator are being investigated.

Liquidation before all the assets have been dissipated

3.6 A commentator says that perhaps the most serious problem in practice is that insolvency procedures start too late when there is very little left for creditors. He suggests that it should be made easier to sequestrate; the equivalent of the United Kingdom Administration Order should be introduced; and directors should be motivated to "surrender" the company much sooner by providing far more effective remedies and penalties, supported by presumptions and so forth. Another commentator says too often action is taken too late. He submits that the Act should aim at facilitating the liquidation procedure at a time when the debtor is still possessed of assets and is not a hopeless case. The Insolvency Act should assist the creditor to recover money on the one hand and on the other hand assist the honest debtor to "wipe the slate clean" and start afresh. He says disregard for fundamental principles

of integrity, honesty and fair dealing of the persons involved requires attention with a view to cleaning up the practice of insolvency law and raising the ethical standards of those who deal in the field.

3.7 It is agreed that it is undesirable that there are little or no assets in many estates when liquidated. However, there appears to be no magic solution to this problem. Reference is made in paragraph 3.5 above to the limitation of appointments by clause 53 to members of professional bodies. Measures to encourage a fresh start for the insolvent, decriminalisation of the insolvency law, more effective penalties and improved measures to ensure that some creditors do not obtain an unfair advantage are highlighted in paragraph 4 below under the summary of changes proposed in the Bill.

Sequestration without diminution of status and other matters revisited

3.8 The basic premises and principles proposed by one commentator can be summarised as follows:

- (a) Sequestration should merely take away the insolvent's power to dispose over assets and limit his right to incur further debts and should not punish the insolvent by, *inter alia*, diminution of status. If this is the case, sequestration can be dealt with administratively by the Master's Office. On the strength of an investigation authorised by the court it may be ordered that the effects under the present Act will follow.
- (b) All creditors should be bound by the provisions of the Insolvency Act, including the Land Bank.
- (c) Preferences in favour of institutions such as the State (income tax), the Workmens' Compensation Commissioner, etc, should be limited to the absolute minimum.
- (d) Formalities should be limited to the minimum and should be as simple as possible.

3.9 With regard to paragraph (a), a debtor should not be absolved from debts without the cooperation of creditors unless some or other form of investigation has been conducted into the reasons for the inability to pay debts. Schedule 4 of the Draft Bill contains proposals for a composition with creditors which will avoid the ordinary effects of sequestration. It is submitted that further provision for sequestration without diminution of status is not advisable.

3.10 In Working Paper 61 *Statutory Provisions that Benefit Creditors* (par 5.6 on page 12) it was submitted that statutory provisions which prefer creditors are undesirable and cannot be justified

merely because revenue is utilised for the benefit of the public or because the State or State assisted bodies are involved. See the discussion in paragraph 7 below of statutory provisions outside the Insolvency Act that benefit creditors. The preferences in favour of State institutions are discussed with the comments on clause 80 of the Bill, where the abolition of most of the preferences is proposed.

3.11 The view that formalities should be limited to the minimum and should be as simple as possible is supported and was borne in mind when the provisions of the Draft Bill were considered.

4 Summary of changes proposed in the Bill

4.1 The explanatory memorandum below expounds the changes to the present law in detail. Some of the changes are highlighted here.

Generating interest by creditors

4.2 The lack of interest displayed by creditors in the administration of insolvent estates is notorious. The active participation by creditors is important because they often have information that is of value to the liquidator. It is expected from creditors to protect their own interests. They are in a better position than the State or its officials to supervise the liquidation and the liquidator's administration of the insolvent estate. It has been submitted that creditors should, as the interested parties, be allowed to deal with the problem of insolvency with as little as possible interference by the State or its organs.

4.3 The Bill accepts as a general premise that creditors should accept responsibility for the protection of their own interests. In the important matter of the appointment of liquidators the Bill limits the discretion of the Master to appoint a liquidator if a liquidator is nominated or elected by creditors (clauses 32 and the discussion of the clause in the explanatory memorandum).

4.4 One of the reasons for the lack of interest displayed by creditors is that concurrent creditors seldom receive any benefit from the insolvent estate. A survey conducted by the Commission in the office of the Master of the High Court, Pretoria, revealed that concurrent creditors received dividends in only 28,6% of the sequestrations included in the survey. In 40,6% of the cases creditors were required to pay a contribution. (Working Paper 29 Schedule 3. See *Hillhouse v Stott: Freban Investments v Itzkin: Botha v Botha* 1990 (4) SA 580 (W) 586F.) The following provisions of the Bill encourage creditors to participate in the administration of insolvent estates:

4.4.1 The requirement that there is reason to believe that the liquidation of the estate of the debtor will be to the advantage of creditors has been retained (clauses 7(1)(b) and 8(1)(c)). If the first

meeting is held before a final liquidation order is issued, the liquidator's report must deal with the question whether the liquidation will probably be to the advantage of creditors and this question must be considered at the meeting of creditors or a subsequent meeting of creditors (clause 38(6)).

- 4.4.2 In order to discourage liquidations which are not to the advantage of creditors, the security to be given by a creditor who applies for liquidation is extended to cover all costs in respect of the application that might be awarded against the applicant and all costs of liquidation that are not recoverable from other creditors (clause 4(2)(c)). The requirement to give security for costs is extended to applications by the debtor for the liquidation of his or her estate (clause 3(3)(b)). The proposed procedure for a composition between a debtor and creditors before liquidation (Schedule 4) or other debt recovery procedures in the Magistrates Courts can be considered in cases where the value of the assets is not sufficient to ensure that liquidation will be to the advantage of creditors.
- 4.4.3 In addition to the existing requirement of notice of the first meeting in the Government Gazette, provision is made for personal notice to creditors (clause 38(2)). The notice in newspapers that the liquidation account will be open for inspection has been replaced by personal notice to creditors (clause 88).
- 4.4.4 The right of creditors to institute proceedings for the setting aside of dispositions if the liquidator fails to take such steps is extended to any proceedings for the recovery of a debt, asset, compensation, penalty or benefit of any kind for the benefit of the insolvent estate (clause 25(1)).
- 4.4.5 In order to expedite the administration of estates and the payment of dividends to creditors, provision is made for the appointment of a liquidator in every estate soon after the granting of the liquidation order (clause 32(2)). The liquidator must convene a first meeting of creditors within 60 days after his or her appointment where directions in respect of the administration of the estate can be given by creditors (clause 38) in order that the realisation of assets and the administration of the estate can proceed. At present several months elapse after the first sequestration order before a meeting can be held to obtain directions from creditors. If the majority in value of creditors voting at the meeting is not satisfied with the liquidator's report the liquidator must submit a report to an adjourned or subsequent meeting or refer the report to the Master who may give such directions as he or she deems appropriate (clause 38(9)).

4.4.6 One of the reasons why concurrent creditors seldom receive a dividend from the estate, is the preferences payable from the free residue to the State and other creditors and the special rights enjoyed by the State and other persons. The only preferences payable out of the free residue retained in the Bill are those in favour of employees; contributions to employee funds; and claims for arrear maintenance payable in terms of a court order (clause 80). In cases where the debtor failed to submit returns to the Receiver of Revenue, substantial claims are often submitted against insolvent estates by the Receiver with the result that nothing remains for ordinary creditors. Clause 62(7)(d) provides that the liquidator is entitled to be apprised in writing of the basis for any estimated assessment made in terms of any revenue law.

Measures to curb unfair advantage to some creditors

4.5 The Bill contains proposals to ensure that some creditors do not obtain an unfair advantage as a result of the liquidation:

4.5.1 The ordinary rule before insolvency that a creditor must prove a claim on a balance of probabilities is at present undermined by the rule that *prima facie* proof of a claim against an insolvent estate is sufficient. The liquidator is given the right, if authorised thereto by the Master or a resolution of creditors and having afforded the claimant the opportunity of substantiating the claim, to reduce or disallow a claim proved at a meeting (clause 46(4)). The creditor retains the right to establish a claim by means of an action at law (clause 46(5)).

4.5.2 The right to prove a claim in respect of the capital amount of a debt which becomes payable after liquidation is retained, but such a debt is reduced by twelve percent of that amount from the date of the liquidation to the date on which the debt becomes payable (clause 49(3)).

4.5.3 A creditor who, after liquidation of the estate, received payment of a debt proved against the estate from a source other than the insolvent estate must notify the liquidator of such payment (clause 51) to enable the liquidator to ensure that no creditor receives more than 100 cents in the Rand.

4.5.4 The rule that concurrent creditors are entitled to interest after liquidation on their claims only if their claims have been paid in full, is extended to the concurrent part of secured claims (clause 75(5)).

4.5.5 In terms of clause 76, a creditor under a financial lease agreement is, like a suspensive sale creditor, treated as a secured creditor and must prove a claim.

Debtor's opportunity for a fresh start and duty to act honestly and assist in winding up of estate

4.6 It is accepted that a debtor may become insolvent through no fault of his or her own and that such a debtor should be given the opportunity to make a fresh start. Creditors sometimes contribute towards insolvencies by giving credit to debtors who cannot repay it. A balance must be struck between the rights of creditors and giving a debtor an opportunity to make a fresh start. It is, however, expected from debtors to act honestly and assist in the winding up of their insolvent estates.

4.6.1 The property excluded from an insolvent estate is brought into line with property not subject to attachment for payment of debts (clause 11(6)). The liquidator has the power, if authorised by the Master or by resolution of a meeting of creditors, to make further assets available to the insolvent (clause 62(4)(1)).

4.6.2 The insolvent may follow any profession or occupation and may collect for his or her own benefit any remuneration for work done or professional services rendered after liquidation, until the Master has certified that earnings received by the insolvent are not required for the support of the insolvent and dependants and should be paid over to the liquidator of the estate (clause 15(2)). The insolvent must keep a detailed record of all assets and income received and expenses paid. For a period of one year after liquidation the insolvent must send a monthly statement of receipts and expenses to the liquidator and thereafter must, for as long as he or she is insolvent, send an annual return to the liquidator. The liquidator may at any time request particulars of income and expenses. (Clause 15 (3)(a).) A hearing can be held before a magistrate to obtain evidence on the insolvent and his or her household's earnings and expenses for support (clause 15(5)(a)). If an emoluments attachment order issued by a court in respect of a judgment debtor prior to the liquidation of the estate is in force when the estate is liquidated, such order shall remain in force for a period of six months from the date of the liquidation order. The employer upon whom the emoluments attachment order was served shall in accordance with the order make payments to the liquidator for the benefit of the insolvent estate (clause 15(6)).

4.6.3 The value of a debtor's assets to the debtor is usually considerably greater than the amount which the assets would realise on a forced sale. The fact that creditors would probably have to wait a long time for dividends in the ordinary course also plays a role. If a debtor obtains money somewhere or is able to conclude satisfactory arrangements for the payment of debts a composition may be more advantageous for both the debtor and creditors than the liquidation

of the debtor's estate. The required votes for acceptance of an offer of composition is relaxed from 75% in value and 75% in number of all creditors who have proved claims to a majority in number and two-thirds in value of the concurrent creditors who have voted on the offer (clause 71(4)). At present the offer may be made at any time after the first meeting, which is usually held a month or two after the final sequestration order. To expedite matters and prevent unnecessary proceedings, it is provided that an offer can be made at any time after the issuing of the first liquidation order provided that the insolvent has submitted his or her statement of affairs (clause 71(1)). Provision may be made in a composition for the discharge of a provisional liquidation order or the setting aside of a final order upon the acceptance of an offer of composition (clause 71(6)). If creditors accept a composition the debtor may apply for rehabilitation without any requirement of a percentage dividend payable to creditors (clause 96(1)(b)). Provision is also made for an offer of composition before liquidation (Schedule 4).

- 4.6.4 The court may not grant a rehabilitation order until 10 years after the liquidation of a debtor's estate if the court is satisfied on the strength of a certificate by the Master or other evidence that the debtor has intentionally impeded, obstructed or delayed the administration of the insolvent estate (clause 97(2)). Claims which are not discharged by rehabilitation have been expanded by adding to claims arising out of fraud, claims arising after an insolvent obtained credit by giving false information or after an insolvent falsely concealed insolvency in respect of a previous liquidation (clause 99(1)(b)).

Measures against dishonest or incompetent liquidators

4.7 In the light of consistent complaints that some liquidators act dishonestly or that they are not competent, the Bill contains the following provisions:

- 4.7.1 Only a person who is a member of a professional body recognised by the Minister of Justice and who is permitted to act as a member of that body in terms of its rules may be appointed as liquidator (clause 53(1)(a)). The Minister may from time to time publish the name of a recognised professional body if it appears to the Minister that such body regulates the practice of a profession and maintains and enforces rules for ensuring that a member is a fit and proper person to be appointed as liquidator and meets acceptable requirements for education and practical experience and training (clause 53(2)). The Minister may revoke the recognition of a professional body if it no longer satisfies the requirements (clause 53(3)).
- 4.7.2 The Master may, after a liquidator has been charged with an offence or on the strength of a complaint made to him on affidavit, pending an investigation into the suitability of a liquidator

to remain in office, suspend the liquidator from office and, if necessary, appoint an interim liquidator for the preservation of the estate (clause 58(2)).

4.7.3 The Master may (as is provided in the Companies Act) appoint a person to investigate the affairs of a liquidator (clause 68(2)).

Constitutionality of provisions

4.8 The following provisions that may breach the Constitution have been removed:

4.8.1 Discrimination between husbands and wives in respect of the protection of benefits under antenuptial contracts (clause 19(1)).

4.8.2 A review by the Minister which bars a review by the courts (clause 54(3)).

4.8.3 A provision that the Master is not required to specify his reasons for refusing to appoint a particular person as liquidator (clause 54(2)).

4.8.4 Presumptions in connection with criminal offences (clause 101).

4.9 The definition of "spouse" in clause 1 applies to persons of the same sex living together as if married.

4.10 Enforcing summonses and giving of evidence are in accordance with decisions of the Constitutional Court (see the explanatory memorandum on clause 68A).

Expedition of administration

4.11 The following provisions are intended to expedite the administration of insolvent estates:

4.11.1 The court is given a discretion to issue a final liquidation order without a rule **nisi** (clause 8(1)).

4.11.2 The existing practice that a liquidator may attach assets himself and need not wait for the sheriff to attach assets has been embodied in the Bill (clause 33).

4.11.3 In order to avoid delays experienced in connection with questionings at meetings, provision is made for the liquidator to call for records and books (clause 67(7) and (8)), for interrogations before a commissioner (clause 66) and for written questions by the liquidator (clause 67(1)).

4.11.4 The taxation of costs is dispensed with if the liquidator (properly authorised thereto by the Master or creditors) has entered into a written agreement with a legal adviser or legal representative in respect of a tariff of remuneration for services (clause 81(1)).

4.11.5 Resolutions can be adopted at the first meeting convened by the initial liquidator (clause 38).

4.11.6 Most meeting may be held before the liquidator (clause 41(3)).

Partnerships

4.12 The following provisions are proposed in respect of partnerships:

4.12.1 Provision is made for the liquidation of a partnership where there is no partner whose estate may be liquidated in terms of the insolvency law (clause 5(4)).

4.12.2 When the estate of a partner is liquidated without the estate of the partnership being liquidated, partnership claims against the partner's insolvent estate are regarded as unliquidated until partnership debts have been settled in terms of the dissolution of the partnership (clause 43).

4.12.3 When the estate of a partnership and the estates of the partners are under liquidation simultaneously a shortfall of a partnership claim against the partnership estate ranks against the estates of the partners without formal proof of the claim (clause 44).

Voidable dispositions

4.13 In respect of dispositions before liquidation that may be set aside, wider provisions apply to associates of the insolvent than to other persons (clauses 18 and 20).

4.14 In proceedings to set aside dispositions it is presumed, until the contrary has been proved, that a debtor's liabilities exceeded his or her assets at any time within three years before the liquidation of the estate (clause 25(2A)).

4.15 Provision is made for the payment of interest if a disposition is set aside (clause 25(3)).

4.16 A cap of R200 000 has been placed on the exclusion of pension benefits claimable by the insolvent prior to rehabilitation in the year after the date of liquidation or a subsequent year (clause 15(4)).

4.17 Certain contributions to pension funds may be recovered for the benefit of insolvent estates (clause 22).

Criminal sanctions

4.18 It appears that very few insolvents are punished effectively for offences committed by them. As an insolvent has his or her own funds from which a fine can be paid, provision is made for fines. A fine is a more effective punishment than a jail sentence suspended on a condition which is highly unlikely to be fulfilled. Offences which can be dealt with in terms of the common law have been omitted. Presumptions have been omitted. Some offences have been replaced by provisions that delay rehabilitation. (Clauses 101 and 97(2).)

Simplification of formalities

4.19 The formalities for the voluntary surrender of an estate have been simplified (clause 3). The power to dispense with non-compliance with provisions of the Act has been redefined and expanded (clause 110). Many of the changes in the Bill are aimed at clarifying and simplifying the existing position. It is submitted that the value of such changes should not be underestimated. Examples of such changes are the substitution of two types of meetings for the existing four types (clauses 38-40), the new definitions for secured creditors, preferent creditors and concurrent creditors (clause 2), the reorganisation and adaptation of provisions in respect of secured claims (clauses 73 to 75) and the powers of liquidators, whether provisional or final (clause 62).

Modern technology

4.20 The definition of "book" or "books" in clause 1 provides for information stored on electronic or mechanical devices.

4.21 The definition of "personal notice" in clause 1 provides for notice by telefax and electronic mail.

4.22 Provision is made for the electronic transfer of funds instead of payment by cheque (clause 92(1)).

5 Uniform provisions for corporate and individual insolvencies

5.1 There is strong support for uniform provisions for all corporate and individual insolvencies, at least as regards the administration of the liquidation process, with nuances for banks, insurance companies and others where such differences are justified by structural requirements. Strong support

was apparent not only from comments on Discussion Paper 86, but also at a symposium and a subsequent conference held to discuss uniform provisions. Uniform provisions for individuals and companies have been developed under the auspices of the Standing Advisory Committee on Company Law.

5.2 The project committee holds the view that the review of corporate insolvency should be finalised simultaneously with the review of provisions for individuals for, amongst others, the following reasons:

5.2.1 Once a start has been made it is surprising how easy it is to unify the provisions.

5.2.2 A unified Act is more user friendly, especially for foreigners like prospective foreign investors.

5.2.3 Corporate insolvencies far exceed individual insolvencies in terms of value.

5.2.4 Unnecessary differences complicate matters and are mostly inexplicable.

5.2.5 If the opportunity is not taken to enact a unified Act now it may not arise again in the near future.

5.2.6 It is easier to make amendments to a single Act than to separate Acts administered by different Ministers and considered by different portfolio committees.

5.2.7 There will be confusion if the insolvency law relating to individuals is reformed and nothing is done in connection with corporate insolvencies.

5.3 The Commission appreciates the importance of corporate insolvencies and the benefits of uniform legislation. Many of the provisions applicable to individual insolvencies apply to corporate insolvencies as well. It is important to commence the debate on provisions that are desirable for individuals so that the appropriate provisions can be finalised for individuals and for incorporation in the envisaged uniform legislation for all insolvencies.

5.4 Considerable progress on the finalisation of uniform legislation has been made by the Centre for Advanced and Corporate Insolvency Law of the University of Pretoria (a separate volume will be made available to the Minister). It is envisaged that proposals by the Standing Advisory Committee on Company Law, which incorporate the proposals for individuals in this report, will be available in the near future.

6 UNCITRAL Model Law on Cross-Border Insolvency

On 17 June 1999 the Commission submitted an interim report which recommends the enactment of the UNCITRAL Model Law on Cross-Border Insolvency, adapted for enactment in South Africa. Bill 4 of 2000, based on the recommendations in the report, has been introduced in Parliament. *It is proposed that the introduction of legislation on the Model Law should not be delayed by*

consideration of new insolvency legislation. New insolvency legislation can incorporate any legislation already enacted to give effect to the UNCITRAL Model Law.

7 Statutory provisions outside the Insolvency Act that benefit creditors

7.1 Working Paper 61 dealing with *Statutory Provisions that Benefit Creditors* was published for comment late in 1995. Comments on the working paper were furnished by 36 commentators.

7.2 Aspects of Working Paper 61 that relate to provisions of the Insolvency Act are dealt with in the Draft Bill and explanatory memorandum. About half of the commentators on Working Paper 61 commented on behalf of local authorities on special rules for the payment of "taxes" to local authorities. This matter is dealt with in clause 75 of the Draft Bill and the explanatory memorandum on the clause. Proposals for changes to legislation outside the Insolvency Act are dealt with here. No draft provisions were published for comment and changes proposed below to provisions outside the Insolvency Act are not reflected in the Draft Bill.

7.3 *It is submitted that statutory provisions which prefer creditors are undesirable and cannot be justified merely because revenue is utilised for the benefit of the public or because the State or State assisted bodies are involved.*

7.4 *As a basic premise it is submitted that creditors who enjoy special statutory protection should have the same rights as common law secured creditors. The same rules regarding realisation of security by the liquidator, proof of claim by the creditor, etc, should apply.*

7.5 In February 1991 a committee under the chairmanship of Dr A S Jacobs made available the *Verslag van die Landbouwerkkomitee insake Landboufinansiering en die Versterking van Koöperasies se Kapitaalstruktuur*. The majority of the Committee, excluding the representatives of the South African Agricultural Union, recommended (paragraph 21 at page 142 of the report) that the pledge system in respect of co-operatives should lapse. The Final Report of the Commission of Inquiry into the *Provision of Rural Financial services* ("Strauss Commission") RP 108/96 dated 18 September 1996 recommended that the legislative provisions designed to provide preferential creditor status to the Land Bank, the Agricultural Credit Board and the co-operatives, should be reviewed. No one working on such a review could be traced. *It is submitted that the pledge system in respect of co-operatives, provided for in sections 173 and 174 of the Co-operatives Act 91 of 1981 should lapse, subject to the retention of rights acquired by virtue of the system in respect of amounts advanced before the date when the legislation repealing the statutory pledges comes*

into operation.

7.6 The report of the Strauss Commission (referred to in the previous paragraph) made the following recommendations:

1. The legislative provisions designed to provide preferential creditor status to the Land Bank, the Agricultural Credit Board and co-operatives, should be reviewed.
2. Consideration should be given to the introduction of a Pledge Registration Office, where pledges of movable objects could be registered. The registration of such pledges must be simple and cheap.
3. The credit provision facilities of the Agricultural Credit Board should be terminated as soon as possible and the loan books, suitably vetted or guaranteed, transferred to the Land Bank.

Recommendation 3 above was implemented by the Land Bank Amendment Act 21 of 1998. This will have the effect that the special provisions in the Agricultural Credit Act 28 of 1966 will be phased out over time.

7.7 According to comments by the Land Bank during 1996 the Land Bank Act in its existing form was no longer in tune with changed conditions and it had been decided to pass legislation during (hopefully) 1996 which would replace the Land Bank Act, providing for the total restructuring of the Bank's activities. The new legislation would not provide for any powers of execution without court order (compare sections 34 and 55 of the Land Bank Act 13 of 1944). The envisaged legislation also provided for the repeal of section 90 of the Insolvency Act. The manager of the Land and Agricultural Bank was satisfied that the new legislation would be in line with the recommendations contained in Working Paper 61 and therefore contribute in a constructive way to eliminating any disparity which might exist in the area of agricultural financing. According to an official at the Land Bank the proposed reforms were not proceeded with and there are no plans to proceed with such reforms at present. Section 38(2) of the North West Agricultural Bank Act 14 of 1981, which is similar to section 55(2) of the Land Bank Act, has been declared unconstitutional (*Lesapo v North West Agricultural Bank* 1999 (12) BCLR 1420 (CC)). ***It is recommended that the steps to promote legislation to remove special protective measures for the Land Bank should be revived as a matter of urgency.***

7.8 Unsatisfactory aspects in sections 22, 23, 35 and 42 of the Agricultural Credit Act 28 of 1966

will disappear as a result of the phasing out of financing under the Agricultural Credit Act by the Land Bank Amendment Act 21 of 1998. ***It is recommended that section 5 of the Giving of Security by Means of Movable Property Act 57 of 1993 should be amended by removing the provisions that rights acquired under the Agricultural Credit Act are not affected. It is submitted that vested rights will be protected satisfactorily under the ordinary rules against the retrospective operation of legislation and that no transitional provision is necessary.***

7.9 The creation of security instruments in connection with farming operations or a registration system for the pledge of movables (or other security devices regarding movable property such as cession of rights or reservation of ownership) appears to merit consideration, but does not form part of the review of the law of insolvency. ***It is recommended that consideration should be given to the introduction of a Pledge Registration Office, where pledges of movable objects could be registered. The registration of such pledges must be simple and cheap.***

7.10 Section 15B(3)(a) of the Sectional Titles Act 95 of 1986 provides that the registrar of deeds shall not register the transfer of a unit unless a conveyancer has certified that specified moneys have been paid, provision has been made for payment thereof, or no moneys are payable. The effect of this provision is that upon insolvency a preference is enjoyed by the body corporate of the sectional title scheme in respect of pre-liquidation levies. (*Nel v Body Corporate of the Seaways Building* 1995 (1) SA 130 (C) and 1996 (1) SA 131 (A).) The Institute of Estate Agents of South Africa made representations for this protection for bodies corporate of sectional title schemes. The protection has to do with the payment of municipal taxes and other monies, but it is basically in favour of a private institution, namely the body corporate of the sectional title scheme. The motivation was purely that losses were suffered in the event of insolvency. No particular reasons were advanced why the parties involved could not themselves take steps to protect their interests or why the body corporate was entitled to special protection. Although the parties involved will no doubt complain if the protection is removed it is quite remarkable that the special protection was conferred at all.

7.11 C G van der Merwe "Does the restraint on transfer provision in the Sectional Titles Act accord sufficient preference to the body corporate for outstanding levies?" 1996 *THTHR* 367 says levies are the main source from which the body corporate finances the cost of maintenance and administration of a sectional title scheme; failure by one owner to pay levies might lead to insolvency of the body corporate for which the other owners are personally liable in proportion to their participation quotas; since the efficient maintenance and administration of a scheme is to the advantage of every single unit owner he submits that the body corporate's interest in receiving most of the levies due to it, justifies the creation of a statutory mortgage in favour of the body corporate to secure outstanding levies; he

proposes a preferent right with regard to six months' arrear levies only (on page 386). He submits that the six months' priority strikes an equitable balance between the need to enforce collection of unpaid levies and the obvious necessity to protect the security interests of mortgage lenders (on page 387).

7.12 Professor Van der Merwe does not refer to Working Paper 61 in his article. The reasons for the preference given by Professor Van der Merwe do not justify special protection. ***It is submitted that the special protection conferred in section 15B(3)(a) of the Sectional Titles Act 95 of 1986 is not justified.***

7.13 There is justification for the provisions of section 10 of the Admiralty Jurisdiction Regulation Act 105 of 1983 that property subject to admiralty jurisdiction should first be applied in terms of the rules in section 11 of that Act before the balance is paid over to a trustee, liquidator or judicial manager in terms of section 11(13). It is also acceptable that the position that applies before sequestration in respect of the preference of ship mortgages should be maintained after sequestration. However, the reform of the position before sequestration does not form part of the review of the law of insolvency.

7.14 The following provisions are acceptable:

7.14.1 Section 8 of the Convention on the International Recognition of Rights in Aircraft Act 59 of 1993, which provides that the right of preference given to a mortgagee by a registered mortgage of an aircraft is not affected by sequestration of the estate of the mortgagor.

7.14.2 Provisions such sections 18 and 20 to 22 of the Alienation of Land Act 68 of 1981 that protect a purchaser of immovable property.

7.14.3 The provisions regarding restraint orders and related matters in the Prevention of Organised Crime Act 121 of 1998 and the International Co-operation in Criminal Matters Act 75 of 1996.

7.14.4 The following provisions that provide that trust property does not form part of the property of a person: section 12 of the Trust Property Control Act 57 of 1988; section 79 of the Attorneys Act 53 of 1979; section 32(8) of the Estate Agents Act 112 of 1976; section 19(5) of the Agricultural Produce Agents Act 12 of 1992; section 74J(7) of the Magistrates' Court Act 32 of 1944 (duties of administrator); section 22 of the Sheriff's Act 90 of 1986; section 14(6) of the Stock Exchanges Control Act 1 of 1985; and section 17B(6) of the Financial Markets Control Act 55 of 1989.

7.14.5 The following provisions that consideration must be repaid if a person referred to in the particular Act becomes insolvent: section 5A(3) of the Share Blocks Control Act 59 of 1980; section 6(4) of the Housing Development Schemes for Retired Persons Act 65 of 1988; section 26(4) of the Alienation of Land Act 68 of 1981; and section 7(4) of the Property Time-sharing Control Act 75 of 1983.

7.15 The provisions of section 24 of the Electricity Act 41 of 1987 and section 88 of the Defence Act 44 of 1958, which exclude certain assets from an insolvent estate, do not appear to create problems in practice.

7.16 With reference to section 14(5)(b) of the Agricultural Produce Agents Act 12 of 1992, it is submitted that the “council” should have the rights of an ordinary secured creditor.

7.17 In the absence of reasons for the following provisions they should be repealed:

7.17.1 Section 5A of the National Supplies Procurement Act 89 of 1970, which excludes certain assets from an insolvent estate.

7.17.2 Section 18 of the Correctional Services Act 8 of 1959, section 58 of the South African Police Service Act 68 of 1995 and section 139 of the Defence Act 44 of 1957 that exclude salaries from insolvent estates.

7.18 The provisions in section 18A of the Community Development Act 3 of 1966 can be criticised and should be reconsidered because security by the State or other persons should be dealt with as is done with ordinary secured creditors.

7.19 The following provisions are not justified:

7.19.1 Section 19 of the Atmospheric Pollution Prevention Act 45 of 1965 provides that a local authority may, where another person fails to do so, take measures to prevent the emanation of smoke. The costs with interest thereon form a first charge against the land after expenses referred to in section 89 of the Insolvency Act.

7.19.2 Section 27 of the Health Act 63 of 1977 contains a similar provision in respect of costs and measures taken to prevent a condition that is offensive or a danger to health.

7.19.3 Section 92(4) of the Water Act 54 of 1956 provides that rates levied by an irrigation board enjoy a preference in the event of insolvency above any registered mortgage bond, subject to the provisions of section 89(1) of the Insolvency Act.

7.20 The lien in section 114 of the Customs and Excise Act 91 of 1964 provides extraordinary protection at the expense of creditors.

7.20.1 The lien is established, not only in respect of goods belonging to the debtor, but also in respect of other goods in the possession or under the control of the debtor. An asset may be subject to the lien although it is not used illegally or although duty is not evaded and although the owner is unaware that duty has not been paid.

7.20.2 Comments were invited on a proposal that the lien should be limited to property attached in terms of section 114(2) before insolvency; that the lien should be limited to property of a person liable for duty or a levy or of persons who are guilty of or take part in tax evasion; and that the rights of the State as lienholder should be limited to the rights enjoyed by an ordinary lienholder on insolvency.

7.20.3 The Commissioner for Customs and Excise says that amounts are not necessarily paid at the time when they become due; the Office of the Commissioner can be distinguished from ordinary creditors in that there is no financial gain for the Office in allowing credit balances to accumulate because finance charges on outstanding balances are not charged and interest is levied only if the debtor is *in mora*; the taxpayer, and as a result his creditors, enjoy the benefit that money due to the State is in his possession and money need not leave his estate to pay monthly interest. The Commissioner says if the Commissioner is not afforded a lien without possession as contemplated in section 114(1)(aA), the only alternative is for security to be taken in the form of guarantees. The financial implications for the debtor before insolvency and consequently for the economy of the country, have already been elucidated. (In a previous submission the Commissioner indicated that tax up to R23 000 000,00 will have to be insured. The excise duty of other firms amounts to up to R70 000 000,00 per month. The monthly cost to maintain a guarantee as insurance for these amounts will have the result that several firms will not be in a position to continue with business. This type of insurance will probably only be obtainable abroad and as a consequence currency will leave the country.) The Commissioner submits that parties who are affected should be approached with a view to gauging their opinions. The Commissioner submits with regard to the proposed limitation of the lien (to property of a person

liable for duty or a levy or of persons who are guilty or take part in tax evasion) that if these provisions are not declared unconstitutional by the Constitutional Court, they should remain in the present form.

7.20.4 The general comments of the Commissioner did not find favour with the Commission when the preference in section 99 of the Insolvency Act was considered in 1984 (see the explanatory memorandum on clause 80). The suggestion by the Commissioner that parties who are affected should be approached with a view to gauging their opinions probably refers to parties liable for the taxes. It stands to reason that debtors would prefer special rights which affect their creditors to security requirements which affect themselves. The view of the Commissioner appears to be that because the legislature has the power to enforce special rights this is preferable to the ordinary rules applicable to all commercial transactions. It is submitted that the matter should be approached with normal commercial principles as guideline. Surely the fact that massive debts are involved and that furnishing of security may be problematic cannot be conclusive. Similar situations are addressed in ordinary commercial transactions and difficulties to obtain and the cost involved in furnishing security are important factors to be taken into account. The difference that the Commissioner's debtors are not "voluntary" in the sense that they cannot be selected is not conclusive and was rejected by the Commission when the preferent claim was considered. The fact that a group of debtors are liable for debts by legislation does not justify special measures to the prejudice of other creditors of the debtor. The mere fact that a provision has not been found unconstitutional is not conclusive. It is clearly an extraordinary measure to attach the assets of a person who is not liable for duty or a levy, or not guilty of or taking part in tax evasion.

7.20.5 *It is submitted that the lien in terms of section 114 of the Customs and Excise Act 91 of 1964 should be limited to property attached before insolvency in terms of section 114(2). It is further submitted that the lien should be limited to property of a person liable for duty or a levy or of persons who are guilty of or take part in tax evasion. Lastly, it is submitted that the rights of the State as lienholder should be limited to the rights enjoyed by an ordinary lienholder on insolvency.*

8 Commentators who commented on Discussion Paper 86: Draft Insolvency Bill and Explanatory memorandum

The following commentators commented on Discussion Paper 86:

Ailola, Professor David, University of South Africa

Asprey, Mr R N, Senior Legal Adviser First National Bank

Boraine, Professor A, Professor B P S van Eck, Ms S Lombard, University of Pretoria

Budow, Marilyn, attorneys EFK Tucker INC

Commissioner for Inland Revenue Service

Congress of South African Trade Unions (COSATU)

Edeling, Chris

Free State Society of Advocates, comments by P Zietsman

Law Society of the Cape of Good Hope, comments by the insolvency committee

Louw, J M A, attorneys Rushmere Noach

Manamela, Solly, attorneys Manamela INC

Moodley, SS, Master of the High Court Grahamstown

Nel, Basil, PriceWaterhouseCoopers Financial Advisory Services (Pty) Ltd

Olivier, D G, attorneys Olivier Lourens Beckley & Fourie

Roestoff, Melanie, University of Pretoria

South African Institute for Sheriffs

South African Police Service, Commercial Branch Head Office

Van der Linde, K E, University of South Africa

Van der Merwe, H P J, Deputy Master of the High Court, Grahamstown.