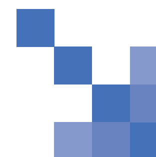
South Africa



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SECURITY AND PRIORITIES

1. What are the most common forms of security taken in relation to immovable and movable property? Are any specific formalities required for the creation of security by companies?

Immovable property

The most common types of security taken over immovable property are covering and surety mortgage bonds. Covering mortgage bonds are generally used to secure all indebtedness of a particular debtor to a particular creditor while surety mortgage bonds are used to secure a suretyship or guarantee that has been provided.

Movable property

The most common forms of security taken over movable property are:

- **Special notarial bonds.** These constitute a form of real security (a statutory pledge) over assets specially described and identified in the bond.
- **General notarial bonds.** A general notarial bond does not need to describe the specific assets involved and covers all movable property of the debtor. A general notarial bond gives a creditor a preference over unsecured claims in respect of the free residue of the insolvent estate (*see below, Formalities*). A creditor must apply to the court to perfect its security in terms of a general notarial bond. On perfection the creditor becomes a secured creditor and may take possession of the assets in question.
- **Cessions of book debts and other intangible rights.** In the event of a liquidation the assets subject to a cession continue to vest in the liquidated company and in practice the liquidator will realise the security and pay the proceeds to the creditor.
- **Pledges of shares and loan accounts.** In the event of a liquidation the assets subject to a pledge continue to vest in the liquidated company and in practice the liquidator will realise the security and pay the proceeds to the creditor.
- **Suretyships and guarantees.** These do not constitute real security in that the creditor who holds the suretyship or guarantee will merely have a concurrent claim against such surety or guarantor.

Formalities

Mortgage bonds must be registered by the Registrar of Deeds, at the Deeds Office, which covers the area the property is situated. South Africa has a sophisticated system of land registration that records all details relating to property including ownership and encumbrances.

Both general notarial bonds and special notarial bonds must be registered in the Deeds Office.

There are no specific formalities for other forms of security other than properly drawn up and executed documents.

2. Where do creditors and shareholders rank on the insolvency of a company?

The order of priority is normally:

- **Liquidation costs.** The costs of the liquidation must be paid prior to creditors receiving any dividend on their claim.
- **Secured creditors.** Secured creditors rank first on insolvency and are paid from the proceeds of the sale of the secured asset. Where a secured creditor's claim is not satisfied in full, the unpaid balance is considered a concurrent claim (*see below, Concurrent creditors*).
- **Preferent creditors.** Preferent creditors are creditors who do not hold security for their claims, but rank above concurrent creditors. They are paid from the proceeds of unencumbered assets in a pre-determined order as set out in the Insolvency Act 1936. Preferent creditors include employees' remuneration (up to a prescribed amount) and the South African Revenue Service. The holder of a general notarial bond is the lowest ranked preferent creditor.
- **Concurrent creditors.** Concurrent creditors (*see Question 2, Secured creditors*) are paid from any proceeds of unencumbered assets that remain after preferent creditors have been paid in full. They are paid in proportion to the amounts owing to them.

Any sums that remain after the payment of all concurrent claims in full, must be used to satisfy the interest on concurrent claims from the date of liquidation to the date of payment, in proportion to the amount of each concurrent claim.

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If all creditors and the costs of the liquidation are paid in full, any amounts remaining must be distributed among the shareholders according to their rights and interests in the company. Where shareholders are creditors by means of loan accounts, they are treated like any other creditor. In this regard, shareholders may hold security for their loan account claims and in doing so are treated as other secured creditors, failing which they are treated as concurrent creditors.

3. Are there any mechanisms used by trade creditors to secure unpaid debts?

Trade creditors use all the forms of security referred to in *Question 1*. A retention of title clause, known in South Africa as a reservation of ownership clause, is also commonly used. If a reservation of ownership clause is validly incorporated in the agreement between the trade creditor and the debtor, the trade creditor is treated as a secured creditor for the property over which ownership has been reserved. The property is sold in the liquidation and the proceeds are allocated to the trade creditor. Any surplus remaining after the trade creditor has been paid in full is distributed to concurrent creditors.

Where a creditor takes security when the debtor company is already insolvent, the security may be voidable (*see Question 7*).

4. Are there any procedures (other than the formal rescue or insolvency procedures described in *Question 5*) that can be invoked by creditors to recover their debt?

Creditors can use standard debt recovery procedures through court actions or applications to recover debts.

RESCUE AND INSOLVENCY PROCEDURES

5. Please briefly describe rescue and insolvency procedures that are available in your jurisdiction. In each case, please state:

- **The objective of the procedure and, where relevant, prospects for recovery.**
- **Companies to which it can potentially apply.**
- **How it is initiated, when and by whom.**
- **Substantive tests that apply (where relevant).**
- **How long it takes.**
- **The consents and approvals that are required.**
- **The effect on the company, shareholders and creditors.**
- **How the procedure is formally concluded.**

Liquidation (winding up)

- **Objective.** A liquidation places a company in financial difficulty under judicial protection. The rights of creditors as at the date of the liquidation are frozen to prevent certain creditors from being preferred and/or enhancing their position at the expense of others. Additionally a liquidator is appointed to realise and distribute the assets to creditors.
- **Companies.** Liquidation can be used for any company.
- **How, when and by whom.** A liquidation is started by an application to the court on notice to the company. This can be done by creditors, shareholders or the company itself.
- **Substantive tests.** A company can be wound up by the court if any of the following apply:
  - the company is unable to pay its debts;
  - it appears to the court that it is just and equitable;
  - the company itself has resolved, by special resolution, to be wound up;
  - the company commences business before the Registrar of Companies (Registrar) certified that it was entitled to do so;
  - the company does not commence business within a year from incorporation or has suspended its business for a year;
  - in the case of a public company, the number of shareholders has been reduced to below seven;
  - 75% of the issued share capital of the company has been lost;
  - in the case of an external company, the company is dissolved in the country in which it was incorporated.

The main grounds on which companies are placed in liquidation are the company's inability to pay its debts and that it is just and equitable to do so. In assessing just and equitable grounds the court has wide discretion and must take into account all the relevant circumstances. An applicant that seeks to rely on just and equitable grounds, must come to court with "clean hands", that is, the applicant cannot itself be wrongfully responsible for the circumstances leading to the application. The five broad categories of just and equitable grounds for the winding up of a company are:

- the disappearance of the company's substratum (that is, where it has become impossible for the company to continue to operate its business);
- illegality of the objects of the company and fraud committed in connection with this;
- deadlock (between members or directors);
- grounds analogous to those that allow the dissolution of partnerships;
- oppression, which involves the unjust and inequitable treatment of minority shareholders.

Country Q&A

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- **How long.** A court application can be made and granted urgently, often on the same day if necessary. In normal circumstances (that is where there is no urgency) a provisional order can be granted within a week of the issue of the court application if unopposed. If the application is opposed it can take months to obtain a hearing date. The exact length of time depends on available court dates.

  The length of the entire winding-up process depends on the nature of the matter. Dividends to creditors can generally only be paid after confirmation of a liquidation and distribution account, which is only prepared once assets are realised and cash is available for distribution.

  A first liquidation and distribution account can be prepared within six months of the liquidation order. Before this stage, a creditor that holds security can ask the liquidator to pay an advance dividend subject to confirmation of the liquidation account. Subsequent accounts are prepared until all the proceeds of the asset realisations have been distributed.

- **Consents and approvals.** A short report must be filed by the Master of the High Court and a court order is required.

- **Effect.** Once a liquidation order is granted by the court:

  - directors are divested of their powers;
  - subsequent unauthorised dispositions of property are void;
  - creditors cannot initiate proceedings against the company; and
  - all proceedings by or against the company are stayed until a liquidator is appointed.

  Liquidators must realise the assets of the company and distribute the proceeds to creditors. Creditors are dependent on the liquidator to maximise their dividends by ensuring that assets are sold for the highest possible purchase price and by pursuing claims against delinquent directors and other parties who may be liable to the company. Liquidators act on the directions of creditors, which are given at formal meetings. Urgent directions can be obtained from the court.

- **Conclusion.** The winding up of a company is complete when the liquidator has realised all the assets and completed his investigations (including any action that has arisen through this) into the affairs of the company. The liquidator produces a final liquidation and distribution account and makes the final dividend payment to creditors (if any). The Registrar then de-registers the company. Alternatively, a company can be discharged from liquidation by the court where creditors enter into a compromise or arrangement with the company under the Companies Act 1973 (*see below, Compromise agreements and schemes of arrangement*).

Judicial management

- **Objective.** Where a company, usually due to mismanagement, is unable to pay its debts and is therefore no longer a successful concern, the court can (on just and equitable grounds) order that a company be placed under judicial management to enable it to pay off its debts and become a successful concern. This is a cumbersome procedure that is rarely used.

- **Companies.** Judicial management can be applied to any company.

- **How, when and by whom.** Judicial management is initiated by an application to the court, on notice to the company. This can be done by creditors, shareholders or the company itself.

- **Substantive tests.** Judicial management is granted where:

  - a company is unable to pay its debts and is therefore no longer a successful concern; and
  - there is a reasonable probability that if placed under judicial management it will become a successful concern.

- **How long.** Similar time periods that apply to the granting of liquidation orders also apply to judicial management applications (*see above, Liquidation (winding up): How long*).

- **Consents and approvals.** A court order is required for judicial management to take effect.

- **Effect.** A judicial manager (usually a liquidator acting in that capacity) is appointed by the court and seeks to trade the company out of its difficulties usually by reaching a compromise or arrangement with creditors and by proper management of the company.

- **Conclusion.** Judicial management continues until the court is satisfied that the purpose of the order has been fulfilled or that, for any reason, it is undesirable for the order to remain in force. Often companies under judicial management are ultimately placed in liquidation.

Compromise agreements and schemes of arrangement

- **Objective.** A company can enter into a formal, court sanctioned compromise agreement (compromise) or scheme of arrangement (arrangement) with its members and/or creditors (*section 311, Companies Act*). Compromises or arrangements are usually made to avoid liquidation or judicial management proceedings, by creditors effectively agreeing to limit their claims and enabling the company to continue trading.

  The compromise or arrangement must be agreed to by either:

  - a majority in number representing three-quarters in value of creditors or a class of creditors; or
  - a majority representing three-quarters of the votes exercisable by the members or a class of members.

  A compromise or arrangement that is sanctioned by the court is binding on all creditors or classes of creditors or on

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all members or classes of members. It is also binding on the liquidator if the company is already in the process of being wound up.

- **Companies.** A compromise or arrangement can be used by any company.

- **How, when and by whom.** An application to the court can be made by:

  - the company or any member of the company;
  - any creditor of the company;
  - if a company is being wound up, the liquidator;
  - if the company is subject to a judicial management order, the judicial manager.

  In practice, especially where the company is in liquidation, a compromise or arrangement is frequently sought where a third party has acquired control of the company, to ensure that creditors' claims are eliminated or their rights in respect of these claims is ceded to the acquirer.

- **Substantive tests.** The compromise or arrangement must be more advantageous to creditors than if the company was placed in final liquidation. Creditors must be paid a higher dividend than the anticipated liquidation dividend. There are no substantive tests and the court has a wide discretion in approving an offer or arrangement.

- **How long.** After preparing an appropriate scheme of arrangement or compromise, a court order convenes meetings of creditors and/or members. The chairman of those meetings must file a report and a second court application must be made requesting the court to sanction the compromise or arrangement. The entire procedure takes approximately six to eight weeks.

- **Consents and approvals.** An arrangement or compromise requires a court order and the consent of creditors in certain proportions (*see above, Objective*). If the company is in liquidation, a short report of the Master of the High Court is also required.

- **Effect.** The effect is set out in the particular compromise or arrangement adopted. It is binding on all creditors or the relevant class of creditors or on the members or class of members (as appropriate). In relation to a company which is in liquidation, the court will discharge the company from liquidation on sanction of the compromise or arrangement.

- **Conclusion.** Once the compromise or arrangement has been sanctioned by the court, a court-appointed receiver processes the claims of the creditors and makes the necessary payments to them. Funds are distributed after a receivership account is prepared.

LIABILITY AND TRANSACTIONS

6. Are there any circumstances in which a director, parent company (domestic or foreign) or other party can be held liable for the debts of an insolvent company?

Under the Companies Act the court can declare any person, or company, who was knowingly a party to the carrying on of the business of a company in certain ways, 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. This applies where the business has been carried on recklessly or with an intent to defraud creditors of the company or creditors of any other company, or for any fraudulent purpose. This provision also covers parent companies.

A person who is knowingly a party to the carrying on of the business of the company in any of these ways commits an offence and can be liable to a fine or imprisonment for a period not exceeding two years or both. In addition they can be held liable for any debts of the company as the court directs.

7. Can transactions that are effected by a company that subsequently becomes insolvent be set aside?

The following types of transactions can be set aside where a company in financial difficulties is subsequently placed in liquidation:

- **Dispositions made without value.** A court can set aside a transaction where a liquidator proves that either:

  - more than two years before liquidation the company disposed of an asset and immediately following that disposition the company's liabilities exceeded its assets and the disposition was not made for value; or
  - within two years of liquidation the company disposed of an asset not for value.

  A dispostion without value is not established if the person claiming under or benefited by the disposition, proves that the company's assets exceeded its liabilities at the time of the disposition.

- **Voidable preferences.** The court can set aside a transaction where the liquidator proves that within six months before liquidation and immediately after the disposition the liabilities of the company exceeded its assets, unless the person in whose favour the disposition was made proves that it was made in the ordinary course of business and that it was not intended to prefer one creditor over another.

- **Undue preferences.** The court can set aside a transaction where the liquidator proves that after the disposition the company's liabilities exceeded its assets and the disposition was made with the intention of preferring a creditor and the company was subsequently liquidated.

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- **Collusive dealings.** The court can set aside transactions where the liquidator proves that an asset was disposed of in a manner that had the effect of prejudicing creditors or preferring one creditor over another and the disposition was effected by the company in collusion with another.

- **Voidable sales of a business or of property forming part of a business.** Where a company disposes of any business or goodwill belonging to it and the sale is not properly advertised to creditors under the Insolvency Act, the sale will be void against creditors for six months after disposition and will be void if the company is liquidated any time within that period.

All of the above transactions are voidable by the liquidator but, until the transactions are set aside by the court, they stand. The only exception is that of voidable sales of a business or of property forming part of a business, as set out above. Where a liquidator has reason to believe that a transaction may be voidable, it is the liquidator's duty to investigate the transaction and, if authorised by the creditors, the liquidator can launch court proceedings to set the transaction aside. The provisions of the Insolvency Act relating to voidable transactions do not apply to dispositions effected in accordance with the rules of a securities exchange or clearing houses.

8. Please set out any conditions under which a company can continue to carry on business during insolvency or rescue proceedings. In particular:

- **Who has the authority to supervise or carry on the company's business?**

- **What restrictions apply?**

Liquidation

A company in liquidation can continue to trade. This requires the consent of the court and, in all probability, the consent of the major creditors (as in most circumstances the liquidators require funding to continue to trade). The liquidators supervise the continued trading and all trading is subject to any restrictions imposed by the court or creditors.

Judicial management

A company under judicial management continues to trade under the supervision of the judicial manager.

Compromise agreements and schemes of arrangement

In cases where a compromise or arrangement is used, the company may not be in liquidation or under judicial management at all and therefore can continue trading under the supervision of the usual management. No restrictions apply. If the compromise or arrangement is proposed while the company is in liquidation, any trading is carried out by the liquidator.

INTERNATIONAL CASES

9. Please state whether:

- **Courts in your jurisdiction recognise insolvency and rescue procedures in other jurisdictions.**

- **Courts co-operate where there are concurrent proceedings in other jurisdictions.**

- **There are any international treaties relating to insolvency to which your jurisdiction is a signatory.**

- **There are any special procedures that apply to foreign creditors.**

- **Recognition.** Courts in South Africa recognise foreign liquidators. The procedure is for the foreign liquidator to approach the appropriate court in his own jurisdiction to issue letters of request; this is a request to the South African court to come to the aid of the foreign liquidator. A separate application, attached to the letter of request, is then brought in the South African court by the foreign liquidator.

  The South African court recognises the foreign liquidator as if he were a liquidator appointed in South Africa. The foreign liquidator can then deal with assets belonging to the foreign company located in South Africa and can, for example, hold enquiry proceedings. The South African court protects the rights of local South African creditors and may require that their claims be discharged first out of the South African assets with the liquidator being able to repatriate any surplus to the domicile of the liquidator.

  A foreign representative can apply to a South African court for recognition of his appointment. Once the foreign representative has been recognised, he has standing to initiate any legal action to set aside a disposition that is available to a liquidator under South African insolvency law. The foreign representative can also intervene in any proceedings in which the debtor is a party.

- **Concurrent proceedings.** The South African courts assist foreign liquidators, but do not treat the insolvency proceedings in the foreign jurisdiction and in South Africa as a single bankruptcy procedure. The South African court protects local creditors by giving them the opportunity of proving their claims. Only once the claims of South African creditors have been satisfied in full from the proceeds of the assets in South Africa, is the foreign liquidator able to repatriate the surplus to the foreign jurisdiction.

- **International treaties.** No international treaties apply.

- **Special procedures for foreign creditors.** No special procedures apply to foreign creditors except that they may be required to give security before starting legal proceedings.

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Foreign civil judgments can also be recognised in South Africa under the Enforcement of Foreign Civil Judgments Act 1998. For this to apply:

- the judgment must be final;
- the foreign court must have had jurisdiction over the matter under South African Private International Law;
- the judgment cannot contravene South African public policy or the rules of natural justice;
- the judgment must not be contrary to section 1 of the Protection of Businesses Act. This section provides that certain foreign orders are not enforceable without the consent of the Minister of Trade and Industry. These orders are widely defined as those which had been handed down in connection with any mining activity, any type of production, possession of any tangible property and almost any other transaction in, outside, into or from South Africa. In practice, the Minister's consent is rarely withheld. In 1995 the South African court held that the Act does not apply to judgments for a monetary amount which arose from a tort or contract, and the prohibition on the enforcement of punitive awards only applies to cases of product liability.

Awards made in foreign arbitration proceedings can similarly be enforced in South Africa under the Recognition and Enforcement of Foreign Arbitral Awards Act 1977. An applicant must apply to court for the award. There are grounds on which a court can refuse to grant an application, for example where the enforcement of the award would be contrary to public policy.

PROPOSED REFORMS

10. Are there any proposals for reform to insolvency law in your jurisdiction?

Insolvency law in South Africa is currently governed by the Insolvency Act. The Companies Act specifies that the majority of sections in the Insolvency Act are also applicable to companies and contains various additional provisions specifically relating to the liquidation of companies. A new Companies Bill has been published for comment and is intended to replace the current Companies Act in the near future. The Bill specifies that those sections of the current Companies Act that deal with the liquidation or winding up of companies are to remain in force until a new Act on insolvency is introduced.

Additionally, the new Companies Bill includes a new business rescue procedure to replace the existing regime of judicial management with a modern business rescue regime. This will be largely self administered by the company under independent supervision and subject to court intervention at any time on application by any of the stakeholders.

The authorities have called for comment in relation to the new Companies Bill. It is uncertain how such comment may affect the draft legislation or when the new legislation will come into effect. Similarly, it is not possible to predict when a new insolvency Act will come into force.

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