Global Restructuring and Insolvency Guide - South Africa

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# Initial Considerations

## Can you take security over all types of assets, including accounts receivable?

Yes. Generally, a creditor is able to take security over all types of assets, including working capital assets and accounts receivable. Security can be taken over both movable and immovable property. Security is most commonly affected over the following:

Land and buildings by the registration of a mortgage bond

Corporeal moveable assets (also referred to as tangible assets) by the registration of a special or general notarial bond. It is also possible to grant security over corporeal movable property by means of a pledge. However, this is less commonly used because it requires the creditor to maintain possession of the pledged property for purposes of perfecting the security. There are other specific forms of security for specific assets such as patents and trade markets, shops, aircraft, etc.

Incorporeal assets (also referred to as intangible assets) by concluding a pledge and cession in *securitatem debiti* (a cession for security). Incorporeal assets include claims to receivables, shares and financial instruments but exclude trademarks, copyright and patents.

## What is the nature of the insolvency process?

**Business rescue**

Business rescue proceedings are regulated in terms of Chapter 6 of the Companies Act, 2008 ("**2008 Companies Act**"). The proceedings seek to facilitate the rehabilitation of a company that is "financially distressed" by providing for the temporary supervision of the company and the management of its affairs as well as a temporary moratorium of the rights of creditors against the company, and the restructuring and reorganizing of the affairs of the business, property, debt and other liabilities and equities of the company. Furthermore, business rescue provides for the development and implementation of a business rescue plan, which seeks to maximize the likelihood that the company will continue to exist on a solvent basis in the future, or where it is not possible for the company to continue on a solvent basis, to ensure a better return for the company's creditors and shareholders than would result from the (immediate) liquidation of the company.

In order for Business Rescue proceedings to be initiated, either the company must be capable of being rescued or it must result in a better outcome for creditors or shareholders than if the company were to be liquidated. Business Rescue proceedings can be initiated in one of two ways:

Voluntarily, by way of a resolution approved by the board of directors of the company concerned

Compulsorily, upon application to the court by any person who is an "affected person" in relation to the company concerned

**Liquidation**

The winding up of a company, also known as liquidation, results in the dissolution of that company and the distribution of its assets among the company's creditors according to their ranking.

Liquidation proceedings can be either voluntary or compulsory, and the process is regulated in terms of different legislation depending on whether the company is solvent or insolvent. Solvent companies are woundup in accordance with the 2008 Companies Act, whereas insolvent companies are wound up in accordance with the provisions of the Companies Act, 1973 ("**1973 Companies Act**").

For asolvent company, the company may be voluntarily wound up by shareholders through the adoption of a special resolution. The resolution must be filed with the Companies and Intellectual Property Commission (CIPC). The resolution must state whether the winding-up is a members' voluntary winding up or a creditors' voluntary winding up. The following apply in the case of a voluntary winding up by the company:

The company must arrange for security for the payment of the company's debts or must obtain consent from the Master of the court to dispense with such security.

The resolution, while not strictly necessary, usually also makes a provision for the appointment of a liquidator.

The compulsory winding-up of a solvent company is initiated through an application to a competent court, accompanied by an affidavit by the party making the application. A court, with jurisdiction, may order that a solvent company be wound up in any of the following scenarios:

The company has passed a special resolution that it will be wound up by the Court.

The company has applied to the court to have its voluntary winding-up continued by the court.

The Business Rescue Practitioner has applied for liquidation on the grounds that there is no reasonable prospect of the company being rescued.

The company or one or more directors or shareholders of the company have applied to the court for an order to wind up the company based on various grounds.

A shareholder has applied, with leave of the court, for an order to wind up the company on the grounds that the directors or other persons in control of the company are acting in a fraudulent or otherwise illegal manner, or that the company's assets are being misapplied or wasted.

The Commission has applied to the court for an order to wind up the company.

An insolvent company may be wound up by the court or voluntarily by the company's creditors or its members through the passing of a resolution.

A court may grant an order for winding up an insolvent company, if one of the following has occurred:

The company has by special resolution, resolved that it be wound up by the court.

The company commenced business before it was entitled to commence business.

The company has not commenced its business within a year from its incorporation or has suspended its business for a whole year.

In the case of a public company, its members have been reduced to below seven.

Seventy-five percent of the issued share capital of the company has been lost or has become useless for the business of the company.

The company is unable to pay its debts.

The company is an external company, the company has been dissolved, or the company has ceased to carry on business in the country in which it has been incorporated.

It appears to the court that it is just and equitable that the company be wound up.

If the application to wind up an insolvent company is successful, the company will be declared insolvent and the company will no longer proceed to operate its business.

**Compromise (creditors' scheme of arrangement)**

A compromise is a voluntary process, provided for in section 155 of the 2008 Companies Act, whereby the board of directors or the liquidator appointed to wind-up a company may propose an arrangement or a compromise of its financial obligations to all, or any class of, its creditors.

A compromise under this section can also provide for a special or alternative means of winding up a company or for the takeover of a company and the termination of the process of the winding-up on the basis of, for example, an acquisition of all its issued shares and its creditors' claims, subject to the discharge of the provisional, or the setting aside of the final, winding-up order.

Section 155 prescribes a process whereby:

All creditors, or a class of creditors, of the company and the CIPC must be provided with a copy of the proposal and notice of a meeting to consider the proposal (section 155 also prescribes the content of the notice).

A meeting must be held where all creditors, or each class of creditors affected by the proposal, may vote on the proposal.

If the proposal is approved by the creditors voting at the creditors' meeting(s), then the company may apply to the court to approve the proposal, thereby making it a court order that will be binding on all of the company's creditors or all members of the relevant class of creditors.

## What is the solvency requirement for a company to file a case in this jurisdiction?

**Business rescue**

The company must be in "financial distress." This means that the company must appear to be reasonably unlikely to pay all of its debts as they become due and payable within the immediately ensuing six months. A company will also be considered to be in "financial distress" if it appears reasonably likely that the company will become insolvent within the immediately ensuing six months. Regardless of the nature of the "financial distress," for business rescue proceedings to be initiated, there must either be a reasonable prospect of rescuing the company or the outcome of the business rescue proceedings must deliver a better outcome for creditors or shareholders than if the company were to be liquidated.

**Liquidation**

A company does not have to be insolvent for liquidation proceedings to be initiated (see section above on solvent companies). In the case of an insolvent company, a company will be deemed insolvent for purposes of liquidation proceedings when its liabilities, fairly estimated, exceed its assets, fairly valued and/or it is unable to pay its debts as and when they fall due in the ordinary course of business.

The 1973 Companies Act provides a number of circumstances in which a competent court can wind up an insolvent company, which include the following:

The company has passed a special resolution resolving for the winding up of the company.

The company commenced business before it was entitled to commence business.

The company has not commenced its business within a year from its incorporation or has suspended its business for a whole year.

In the case of a public company, the number of members has been reduced to below seven.

Seventy-five percent of the issued share capital of the company has been lost or has become useless for the business of the company.

The company is unable to pay its debts.

In the case of an external company, that company is dissolved in the country in which it has been incorporated, or has ceased to carry on business or is carrying on business only for the purpose of winding up its affairs.

It appears to the court that it is just and equitable that the company should be wound up.

**Compromise (creditors' scheme of arrangement)**

There is no solvency requirement. The company must not already be engaged in business rescue proceedings. However, this process can still be followed if the company has commenced a winding-up or liquidation process.

## Is there a requirement to demonstrate COMI ("centre of main interests") for a company to file a case in this country?

**Business rescue**

Only companies incorporated in South Africa and foreign companies that have subsequently been registered as a domestic company in South Africa can be placed into liquidation or business rescue in South Africa under the 2008 Companies Act or the 1973 Companies Act. These processes would not apply to a foreign company registered as an "external company" in South Africa.

**Liquidation**

Only companies incorporated in South Africa and foreign companies that have subsequently been registered as a domestic company in South Africa can be placed into liquidation or business rescue in South Africa under the 2008 Companies Act or the 1973 Companies Act. These processes would not apply to a foreign company registered as an "external company" in South Africa.

**Compromise (creditors' scheme of arrangement)**

Compromise under the 2008 Companies Act can only be used in relation to companies incorporated in South Africa and foreign companies that have, subsequent to their incorporation, been registered as a domestic company in South Africa. This process would not apply to a foreign company registered as an "external company" in South Africa.

## Is restructuring of both secured and unsecured claims possible?

**Business rescue**

Yes. However, such rearrangement must be provided for in the business rescue plan and subsequently approved by the majority of creditors.

**Liquidation**

A liquidator may propose an arrangement or compromise with the company's creditors. This would need to be implemented in accordance with the provisions of section 155 of the 2008 Companies Act, which provides for a scheme of arrangement with creditors. This provision is available for both solvent and insolvent companies. See responses under the heading "Compromise" for more detail.

**Compromise (creditors' scheme of arrangement)**

Yes. Each class of creditors affected by the proposal will need to vote on and approve the proposed scheme of arrangement. Thus, groups of creditors having similar rights would be formed, including secured creditors and different classes of unsecured creditors.

## Are the claims of creditors and shareholders put into separate classes for purposes of voting and treatment under the plan or scheme?

**Business rescue**

Yes.

Payment of the business rescue practitioners' remuneration and all other costs of the business rescue proceedings.

Pre-commencement secured creditors.

Any employees' claims for compensation or remuneration, where such claims arise during the business rescue proceedings.

Post-commencement finance (PCF) creditors (PCF being any finance provided to the company after the start of Business Rescue proceedings). These creditors will be ranked in the order in which they were incurred, irrespective of whether they are secured or not.

Unsecured creditors

For purposes of creditors' voting rights on a business rescue plan, section 145 (4) of the 2008 Companies Act classifies creditors as secured, unsecured and concurrent creditors. A secured or unsecured creditor has a voting interest equal to the value of the amount owed to that creditor by the company. Meanwhile, a concurrent creditor who would be subordinated in liquidation has a voting interest, as independently and expertly appraised and valued at the request of the practitioner, equal to the amount, if any, that the creditor could reasonably expect to receive in a liquidation of the company.

There is a further classification of creditors as "independent creditors," as follows:

A creditor of the company: This may include an employee of the company who is owed any remuneration, reimbursement for expenses or other amount of money relating to employment and which became due and payable before the Business Rescue proceedings.

Is not related to the company, a director, or the business rescue practitioner.

**Liquidation**

Yes, in general terms:

Secured creditors - who are entitled to be paid first from the proceeds of a sale of the secured property in their order of preference, subject to payment of the costs of maintaining and realizing the secured property and a proportionate share of the liquidator's fees and costs.

Preferent creditors - unsecured preferent claims rank for payment out of the free residue of the estate before the claims of concurrent creditors in the following order of priority:

 Costs of the liquidation process, salaries and wages owed to employees, taxes and certain statutory obligations

 Claims secured by a general notarial bond

Concurrent creditors - which have claims that are neither secured nor preferent.

Distributions to shareholders generally rank behind that of creditors.

**Compromise (creditors' scheme of arrangement)**

Yes. For the purpose of assessing the merits of a proposed scheme, the ranking of creditors and shareholders for distributions from an insolvent estate is taken into account. In this scenario, distributions to shareholders generally rank behind creditors' claims. The priority of claims are (in very general terms) as follows:

Secured creditors - who are entitled to be paid first from the proceeds of a sale of the secured property in their order of preference, subject to payment of the costs of maintaining and realizing the secured property and a proportionate share of the liquidator's fees and costs.

Preferent creditors - unsecured preferent claims rank for payment out of the free residue of the estate before the claims of concurrent creditors in the following order of priority:

Costs of the liquidation process, salaries and wages owed to employees, taxes and certain statutory obligations

Claims secured by a general notarial bond

Concurrent creditors - which have claims that are neither secured nor preferent.

Shareholders

## Is shareholder approval needed to commence a case? Are shareholders entitled to vote on a plan?

**Business rescue**

No

**Liquidation**

This depends on the type of liquidation process being followed. For voluntary liquidation proceedings, a special resolution by shareholders must be passed in order to place the company in liquidation. However, no resolution is required where the company is placed in compulsory liquidation.

**Compromise (creditors' scheme of arrangement)**

Generally, no (except to the extent that shareholders have a claim as creditors of the company).

## Are shareholders entitled to vote on a plan?

**Business rescue**

Yes, especially in circumstances where the business rescue plan would alter the rights associated with the class of securities the shareholder falls within.

**Business rescue**

No plan in a liquidation needs to be voted on, and as such, only shareholders that are creditors will be afforded an opportunity to prove their claim in the liquidation.

**Business rescue**

Yes. Shareholders would be required to approve a proposed compromise if the proposal would also affect the rights of shareholders (for example, by diluting their shareholding or amending the rights attaching to existing shares).

## Is there an ability to bind minority dissenting creditors (i.e., cramdown)?

**Business rescue**

Yes. A business rescue plan will be approved preliminarily if it was supported by the holders of more than 75% of the creditors' voting interests that were voted, and the votes in support of the proposed plan included at least 50% of the independent creditor's voting interests, if any, that were voted.

A business rescue plan that has been adopted is binding on the company as well as on each of its creditors and every holder of the company's securities, regardless of whether the person was present at the meeting, voted in favor of the plan or, in the case of creditors, has proved its claim.

If the business rescue plan was rejected, a creditor may make a binding offer to purchase the voting interests of one or more persons who opposed the adoption of the business rescue plan, at a value independently and expertly determined to be the fair and reasonable estimate of the return that such person or persons would receive if the company were to be placed in liquidation.

**Liquidation**

Yes. Any court order to wind up the company will be final and binding on all creditors. In liquidating and distributing the company's assets, the liquidator may also enter into a scheme of arrangement/compromise with creditors in accordance with section 155 of the 2008 Companies Act - see further "Compromise."

**Compromise (creditors' scheme of arrangement)**

Yes. The creditors of a company will adopt a proposal, or a class of creditors, if a majority approves it (in number) of creditors present and voting at a meeting of those creditors called for that purpose and the claims of the creditors approving the proposal represent at least 75% in value of all creditors' claims or claims of that class of creditors, present and voting at a meeting of those creditors called for that purpose.
If the proposal is approved by the creditors voting at the creditors' meeting(s), then the company must (in order to make the compromise final and binding on all creditors) apply to a competent court in order for the compromise to be sanctioned.
A dissenting creditor can oppose this application to a competent court, but in order to be successful with such opposition, a creditor must show that it would be just and equitable for the court to reject the scheme.

# Commencing the Process

## Who can commence?

**Business rescue**

Business rescue can be initiated in one of two ways:

Whereby the company's board of directors passes a resolution by a majority vote to commence business rescue proceedings in respect of the company concerned, provided that the board has reasonable grounds to believe that the company is financially distressed and that there is a reasonable prospect of rescuing the company. It must be noted that the board of directors cannot pass a resolution to commence business rescue proceedings where steps to liquidate the company have already been initiated.

An *"*affected person*"* may apply to court for an order placing the company in business rescue. An "affected person" includes a creditor of the company, a shareholder, a registered trade union representing the company's employees and the individual employees themselves.

For an order to be granted, the affected person must satisfy the court that the company is financially distressed or has failed to pay any amount due in respect of employment-related matters, or that it is otherwise just and equitable to commence the business rescue proceedings and that there is a reasonable prospect of rescuing the company.

**Liquidation**

A voluntary liquidation can be commenced through a special resolution by the company's members or creditors.

A compulsory liquidation is initiated through an application to a competent court, accompanied by an affidavit. This type of application is typically brought by a creditor. However, the company itself, one or more of its members and the master of a competent court all have the requisite standing to bring such an application.

**Compromise (creditors' scheme of arrangement)**

The board of directors or the liquidator appointed to wind up a company.

## Is shareholder's consent required to commence proceeding?

**Business rescue**

No. However, a shareholder is an "affected person" and may therefore commence business rescue proceedings.

**Liquidation**

This depends on the type of liquidation process being followed. Where liquidation proceedings are initiated voluntarily by the company, the shareholders will have to pass a special resolution placing the company in liquidation.

**Compromise (creditors' scheme of arrangement)**

No

## Is there an ability to consolidate group estates?

**Business rescue**

Generally, no.

**Liquidation**

Yes, by way of an application to the high court.1

**Compromise (creditors' scheme of arrangement)**

No, voting would need to take place at the level of each company within the group.

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1. See for example, *Allers and Others v. Fourie No and Others* (491/05) [2006] ZASCA 152 (21 September 2006).

## Is there any court involvement?

**Business rescue**

There will only be court involvement for compulsory business rescue proceedings, whereby an "affected person" makes an application to a competent court to place the company in business rescue.

**Liquidation**

Yes. A court with jurisdiction may place a company in liquidation where an interested party has made an application to a competent court in this regard, regardless of whether the company is solvent or insolvent.

Furthermore, there will be court involvement in certain scenarios, such as if the liquidator wishes to recover assets that were disposed of prior to the liquidation proceedings and that should not have been disposed of.

**Compromise (creditors' scheme of arrangement)**

Yes, if the proposal is approved by the creditors voting at the creditors meeting(s), then the company may apply to the court to sanction and approve the proposal, thereby making it final and binding on all of the company's creditors or all members of the relevant class of creditors.

The court may sanction the compromise as set out in the adopted proposal, if it considers it just and equitable to do so, having regard to the following:

The number of creditors of any affected class of creditors, who were present or represented at the meeting, and who voted in favor of the proposal

In the case of a compromise in respect of a company being wound up, the report of the Master of a competent court on suspected contraventions or offenses and whether or not any director or officer, or past director or officer, of the company is or appears to be personally liable for damages or compensation to the company or for any debts or liabilities of the company.

## Who manages the debtor?

**Business rescue**

The business rescue practitioner and the board of directors of the company, provided that any action is authorized by the business rescue practitioner.

If the board of a company has commenced business rescue proceedings, the company must then (within five days of the commencement of business rescue proceedings) appoint a suitable business rescue practitioner.

Where an "affected person" commences business rescue proceedings through a court application, the relevant person bringing the application will, in the application itself, propose a suitable business rescue practitioner, and the court will make the appointment part of the proceedings.

The business rescue practitioner will then effectively take over the management and control of the company and the company will henceforth only be able to proceed with any substantial process or action with the approval of the business rescue practitioner.

The business rescue practitioner will have the usual fiduciary duties that any other director of the company will have. In addition, the fiduciary duties of the directors of the company in business rescue will persist throughout the business rescue process. The directors will be able to act as such provided that their actions are authorized by the business rescue practitioner.

The company's creditors and securities holders are entitled to participate in the business rescue proceedings. The business rescue practitioner will provide sufficient information to all affected parties to enable them to participate in the business rescue proceedings.

The voting creditors will also be provided with the proposed business rescue plan, which will contain the business rescue practitioner's proposal on how the company will be nurtured back to financial health and on which plan they will eventually vote.

Further to the above, creditors can also establish a creditors' committee to assist the business rescue practitioner.

**Liquidation**

The liquidator.

The liquidator's primary obligation is to see to the winding-up of the company. This requires the liquidator to do the following:

Take possession of the company's assets

Realize such assets

Apply the proceeds toward the payment of the costs of the liquidation proceedings as well as to the creditors in their order of ranking and to thereafter distribute what is left over to the members of the company

Therefore, the company's property will be in the custody of the liquidator from the date of his/her appointment. The liquidator holds a fiduciary responsibility to the company, its members and its creditors, and must therefore act in their collective best interest.

Whilst the debtor company does not lose its corporate identity or title to its assets, from the effective date of the winding up, the powers of the directors cease and the board would no longer have any power to manage the company. However, in a voluntary winding-up, the liquidator, creditors or members may sanction a continuance of directors' powers.

Transparency is essential for liquidation proceedings, especially because there is a risk of contribution from certain creditors if there are insufficient funds or assets available to cover the costs of the administrative expenses of liquidation.

In terms of the 1973 Companies Act, the Master of a competent court must give notice of such liquidation proceedings in the Government Gazette upon receipt of a copy of any winding-up order lodged with them. Where there has been a voluntary winding-up of an insolvent company, the company must, within 28 days after the registration of that resolution, lodge a copy of the resolution with the Master of a competent court and give notice of the winding-up in the Government Gazette.

Furthermore, to provide for continued transparency and disclosure throughout the process, regular creditor and member meetings must be held.

In addition to the above, in terms of the Insolvency Act, 1936 ("**Insolvency Act**") the liquidator must, within six months of being appointed, submit to the Master of the court a liquidation and distribution account of the property in the estate available for payment to creditors.

**Compromise (creditors' scheme of arrangement)**

This depends on whether or not winding up (liquidation) proceedings have been commenced in respect of the company. If no such proceedings have been commenced, then the board of directors will continue to manage the company, whereas if the company is in the process of being wound up (whether solvent or insolvent), the liquidator will take control of the business and the board of directors would no longer have the power to manage the company unless, in a voluntary winding-up, the liquidator, creditors or members sanction a continuance of directors' powers.

## What is level of disclosure of process to voting creditors?

**Business rescue**

The company's creditors and securities holders are entitled to participate in the business rescue proceedings. The business rescue practitioner will provide sufficient information to all affected parties to enable them to participate in the business rescue proceedings.

The voting creditors will also be provided with the proposed business rescue plan, which will contain the business rescue practitioner's proposal on how the company will be nurtured back to financial health and on which plan they will eventually vote.

Further to the above, creditors can also establish a creditors' committee to assist the business rescue practitioner.

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**Compromise (creditors' scheme of arrangement)**

There are significant disclosure obligations to the company's creditors. All creditors that would be affected by the proposed arrangement or compromise, irrespective of the nature of their claims against a company, must be provided with a full and proper explanation in respect of, the proposed scheme. Where the winding-up process has been commenced and the proposed scheme involves the setting aside of the winding-up order or proceedings, the disclosure should, to the extent possible, inform creditors of the dividends that they are likely to receive in terms of the proposal in contrast with those they are likely to receive if the winding-up process were to be completed.

If the scheme includes an acquisition of shares in the company, the information provided to the shareholders and/or creditors should include the price at which the purchaser would obtain shares in the company.

If the company is listed on a securities exchange, additional disclosure requirements may apply.

## What entities are excluded from customary insolvency or reorganisation proceedings, and what legislation applies to them?

The processes described under the Companies Act are available only in relation to companies incorporated or registered under the South African Companies Act, including profit, nonprofit, state-owned (where registered in terms of the 2008 Companies Act) and personal liability companies. Some state-owned entities are governed by their own legislation, and that particular legislation will dictate their winding-up. A trust or a partnership that does not constitute a company for purposes of the 2008 Companies Act cannot be liquidated or placed into business rescue. Rather, where a trust or partnership is insolvent, it (or, more correctly, the estates of the trustees/partners) will be sequestrated in accordance with the Insolvency Act, which applies to *inter alia* all natural persons and unincorporated associations.

In terms of the Insurance Act, 2017, insurance companies may be placed in business rescue or liquidation in terms of the provisions of the 2008 Companies Act, subject to certain specifications. For example, for both business rescue and liquidation proceedings, the Prudential Authority (a regulatory body established in terms of the Financial Sector Regulation Act, 2017) may make an application to a competent court to place an insurance company in business rescue or to have it wound up. Furthermore, a competent court may only grant an order placing an insurance company in business rescue or liquidation if the Prudential Authority has been notified of such.

The insolvency provisions under the Companies Act are modified by the Banks Act, 1990 in relation to companies that are registered banks. In terms of the Banks Act, the Prudential Authority is entitled to make an application to a competent High Court for the liquidation of a registered bank; and to oppose any application made by another person to have a bank wound up. In terms of the Banks Act, 1990, the Prudential Authority is entitled to apply for the liquidation of any entity that fails to comply with a repayment directive issued by the Registrar of Banks pursuant to the entity conducting the business of a bank in contravention of the Banks Act, 1990. Further, only a person recommended by the Prudential Authority may be appointed as a bank's liquidator. The Banks Act also allows the minister of finance (in consultation with the Prudential Authority) to place a bank under curatorship. While not excluded from the provisions of the Companies Act, additional special regulations apply to certain regulated entities operating in the financial sector (under the Financial Sector Regulation Act, 2017).

## How long does it generally take for a creditor to commence the procedure?

**Business rescue**

A creditor may only initiate business rescue proceedings by making an application to a court with the requisite jurisdiction. Unless an urgent application can be justified, the ordinary court procedure may take between 6 and 12 months to complete.

**Liquidation**

A creditor may commence liquidation proceedings in one of two ways, namely by special resolution of the shareholders of the company providing for a winding up by the company's creditors or by way of application to court. Depending on the approach adopted, the time will vary.

An application to a court to place a company in liquidation may take between six and 12 months. On the other hand, a voluntary liquidation simply requires the shareholders to pass a special resolution and then to register the resolution, among other things, with the Companies and Intellectual Property Commission, and is therefore envisaged to take approximately one to two months to initiate.

**Compromise (creditors' scheme of arrangement)**

This is generally not applicable. Although a creditor may make a proposal to the company, the board of directors or liquidator of the company would be required to submit the proposal to its creditors and the commission. No notice period is prescribed for creditors' meetings to be called. However, it has been suggested that (as a minimum) notice periods should comply with the minimum notice period prescribed for shareholder meetings (at least 10 business days).

# Effect of Process

## Does debtor remain in possession with continuation of incumbent management control?

**Business rescue**

The company remains in possession; however, the business rescue practitioner takes over the management and control of the company, and any substantial process or action of the company will require approval from the business rescue practitioner.

**Liquidation**

No. The company may not continue with the business, except insofar as it may be necessary for its beneficial winding up.

**Compromise (creditors' scheme of arrangement)**

Prior to approval of the proposal, creditors would be entitled to attach security in accordance with their rights under the relevant agreement and insolvency laws, generally.

Once the proposal is approved, the debtor would remain in possession of specified assets and continue to manage its business to the extent contemplated in the proposal approved by the creditors or relevant classes of creditors.

## What is the stay/moratorium regime (if any)? Is the stay or moratorium worldwide?

**Business rescue**

The commencement of business rescue gives rise to the imposition of a moratorium on all current and future claims against the company. This includes claims in relation to property belonging to the company or lawfully in its possession. The moratorium means that no legal proceedings, including any enforcement actions against the company or in respect of property belonging to the company or lawfully in its possession, may be commenced or proceeded with against the company.

Further to the above, if a company in Business Rescue wishes to dispose of any property over which another person has any existing security, the company must do the following:

Obtain the prior consent of that other person, unless the proceeds of the disposal would be sufficient to fully discharge the indebtedness protected by that person's security

Promptly pay to that other person the sale proceeds attributable to that property up to the amount of the company's indebtedness to that other person or provide security for the amount of those proceeds, to the reasonable satisfaction of that other person.

The moratorium generally will not operate worldwide.

**Liquidation**

The company or a creditor may apply to court to stay proceedings against the company before the winding-up order is made.

When a court has made an order for the winding-up of a company or a resolution has been passed for the voluntary winding up of a company, the following will take place:

All civil proceedings by or against the company concerned shall be suspended until the appointment of a liquidator.

Any attachment or execution put in force against the estate or assets of the company after the commencement of the winding-up shall be void.

Any person who instituted legal proceedings against a company and which legal proceedings were suspended by the winding-up procedure and any person who intends to institute legal proceedings against the company, shall within four weeks after the appointment of the liquidator give the liquidator at least three weeks' notice before continuing or commencing legal proceedings against the company.

These measures will generally not operate worldwide

**Compromise (creditors' scheme of arrangement)**

The moratorium regime, including its scope and application, is as agreed in the proposal. Consequently, the moratorium would not commence until the proposal is approved. Often an interim moratorium or standstill is agreed with major creditors pending the formal meeting of all creditors to approve the proposal.

To the extent that a creditor has consented to a standstill or the proposal, it would notionally be treated in the same way as any contractual agreement by foreign courts, depending on the particular jurisdiction. Where an approved proposal containing a moratorium has been sanctioned by a South African court order to "cram down" dissenting creditors, the moratorium would then be recognized only to the extent that South African court orders are recognized in a particular foreign jurisdiction.

## Is there a provision for debtor in possession or rescuer financing or superpriority or priming financing?

**Business rescue**

After business rescue proceedings have been initiated, the company may obtain post-commencement funding to enable the company to continue trading. Post-commencement finance does not enjoy a superpriority but can be secured by using an asset of the company that is not already encumbered and may be recovered, whether secured or not secured, after the remuneration and expenses of the business rescue practitioner, employee and claims of secured creditors have been paid.

**Liquidation**

N/A

**Compromise (creditors' scheme of arrangement)**

There is no specific provision for this; however, super-priority financing may be agreed as part of the proposal to be approved by the creditors.

## Can procedure be used to implement a debt-to-equity swap?

**Business rescue**

Yes, as long as it is provided for in the business rescue plan and the business rescue plan has been approved by the creditors.

**Liquidation**

No. The consequence of liquidation proceedings is that the company is dissolved; therefore, a debt-to-equity swap would not be possible.

**Compromise (creditors' scheme of arrangement)**

Yes, a debt-equity swap may be incorporated into a proposal under section 155 of the 2008 Companies Act but this may require additional approvals (including shareholder approvals) to be obtained.

Unless otherwise stated in a company's memorandum of incorporation, the board of directors may issue shares in the company to the extent that there are authorized and unissued shares available to be issued. Shareholder approval by special resolution will be required if:

There are insufficient authorized and unissued shares available to implement the compromise, to increase the number of authorized shares in the company.

The compromise proposes the issuance of shares, securities convertible into shares or rights exercisable for shares and the voting power of the shares that are issued or issuable as a result of compromise will be equal to or exceed 30% of the voting power of all the shares of that class held by existing shareholders.

A separate procedure under section 114 of the 2008 Companies Act must be followed for a scheme of arrangement with existing holders of securities issued by the company.

In the case of private companies, it may further be necessary to procure a waiver of pre-emptive rights held by existing shareholders in relation to any new shares issued by the company.

## Are third party releases available?

**Business rescue**

Yes, provided this is provided for in the business rescue plan, which the creditors have approved.

**Liquidation**

No.

**Compromise (creditors' scheme of arrangement)**

Generally, releases are only available from creditors or affected groups of creditors, which are afforded an opportunity to vote on the proposal. However, a third party may be included in the proposed scheme of arrangement by agreement between such third party, the company and the requisite majority of creditors.1

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1. *Ex parte Cyrildene Heights (Pty) Ltd* 1966 (1) SA 307 (W) at 310; *Du Preez v. Garber: In re Die Boerebank Bpk* 1963 (1) SA 806 (W).

## Are the proceedings recognised abroad?

**Business rescue**

No.

**Liquidation**

This will differ from jurisdiction to jurisdiction.

**Compromise (creditors' scheme of arrangement)**

The procedure relies on an agreement between the company and its creditors, which would be treated in the same way as any contractual agreement by foreign courts.

The company may also apply for the proposal adopted by the relevant creditors to be made an order of court. The proposal would then be recognized to the extent that South African court orders are recognized in other jurisdictions.

## Has the UNCITRAL Model Law been adopted?

**Business rescue**

N/A

**Liquidation**

In 2000, the legislature passed a South African version of the UNCITRAL Model Law, called the Cross-Border Insolvency Act ("**Act**"). The Act provides for a "designation clause," which provides that the Act will only be applicable to countries the Minister of Justice has designated. The Minister of Justice has not designated any countries to which the Act will apply. Therefore, for the time being, cross-border insolvency matters are regulated in terms of the common law.

**Compromise (creditors' scheme of arrangement)**

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## Can a debtor continue to carry on business during insolvency proceedings?

**Business rescue**

Yes.

**Liquidation**

the company may not continue with its business once it has been placed into liquidation, except insofar as it may be necessary for its beneficial winding up.

**Compromise (creditors' scheme of arrangement)**

Yes.

# Other Factors

## Are there any wrongful or insolvent trading restrictions and what is the directors' liability?

The 2008 Companies Act requires that a company must not carry on business recklessly, with gross negligence or with the intent to defraud any person.

Under South African law, directors of a company have a general duty to act in good faith, for a proper purpose and in the best interest of the company. These fiduciary duties of directors require them to act honestly and in good faith and exercise care, skill, and diligence to promote the interests of the company and have a rational basis for decisions made in their role as a director. The 2008 Companies Act imposes personal liability for directors who fail to uphold their duties for loss suffered or incurred by the company or by other affected persons to whom the relevant duty was owed.

**Business rescue**

Payment of the business rescue practitioner's remuneration and all other costs of the business rescue proceedings

Pre-commencement secured creditors

Any employees' claims for compensation or remuneration, where such claims arise during the Business Rescue proceedings

Post-commencement finance (PCF) creditors (PCF being any finance provided to the company after the start of business rescue proceedings). These creditors will be ranked in the order in which they were incurred, irrespective of whether they are secured or no

Unsecured creditors

 **Liquidation**

Secured creditors - who are entitled to be paid first from the proceeds of a sale of the secured property in their order of preference, subject to payment of the costs of maintaining and realizing the secured property and a proportionate share of the liquidator's fees and costs.

Preferent creditors - unsecured preferent claims rank for payment out of the free residue of the estate before the claims of concurrent creditors in the following order of priority:

Costs of the liquidation process, salaries and wages owed to employees, taxes and certain statutory obligations

Claims secured by a general notarial bond

Concurrent creditors - which have claims that are neither secured nor preferent

Distributions to shareholder generally rank behind that of creditors.

**Compromise (creditors' scheme of arrangement)**

For the purpose of assessing the merits of a proposed scheme, the ranking of creditors and shareholders for distributions from an insolvent estate is taken into account, being (in very general terms) the following:

Secured creditors - who are entitled to be paid first from the proceeds of a sale of the secured property in their order of preference, subject to payment of the costs of maintaining and realizing the secured property and a proportionate share of the liquidator's fees and costs

Preferent creditors - unsecured preferent claims rank for payment out of the free residue of the estate before the claims of concurrent creditors in the following order of priority:

Costs of the liquidation process, salaries and wages owed to employees, taxes and certain statutory obligations

Claims are secured by a general notarial bond.

Concurrent creditors - which have claims that are neither secured nor preferent.

Distributions to shareholders generally rank behind that of creditors.

## Do pension liabilities have any priority over other unsecured claims?

**Business rescue**

In a business rescue scenario, the company's obligations in respect of any retirement fund to which it contributes on behalf of employees continue and the company continues to bear liability for noncompliance with its obligations.In particular, the obligations under the rules of the retirement fund and section 13A of the Pension Funds Act, 1956 to contribute to the fund on behalf of employees continue.

**Liquidation**

Creditors of the company have no claim on employees' pension fund assets since these are assets of the pension fund, which is a separate legal person from the employer.

The insolvent company's liability to any retirement funds in which it participates is usually limited to any contributions that were unpaid by it at the date of liquidation. Any such liability would constitute a preferent claim against the company and would therefore have priority over concurrent unsecured claims.

In the (relatively unlikely) event that the insolvent company sponsors a defined benefit pension fund, the company's insolvency would trigger a termination of the fund.

If the fund were in deficit at liquidation, the company would become liable for a debt equal to the value of the active members' statutory minimum benefits and the cost of buying out deferred pensioners' and pensioners' benefits with annuities less the value of the assets of the plan at termination date (section 30(3) of the Pension Funds Act, 1956).This amount would constitute a non-preferent claim.

If the fund were in surplus at liquidation, the surplus may be used to meet unpaid contributions by the employer but would otherwise be used to benefit fund members.

**Compromise (creditors' scheme of arrangement)**

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If the fund were in surplus at liquidation, the surplus may be used to meet unpaid contributions by the employer but would otherwise be used to benefit fund members.

## Is it possible to challenge prior transactions?

**Business rescue**

If at any time during the business rescue proceedings, the business rescue practitioner concludes that there is evidence in the dealings of the company before the business rescue proceedings began of *inter alia* "voidable transactions," the business rescue practitioner must take any necessary steps to rectify the matter and direct management of the company to take appropriate steps.

The 2008 Companies Act does not define what constitutes a voidable transaction. Therefore, the Insolvency Act has been said to apply in this instance with respect to "impeachable transactions," including the following:

Disposition without value

Voidable preference

Undue preference

Conclusive dealings

**Liquidation**

Yes. The liquidator has the means of recovering certain property alienated by the company before its winding-up and the liquidator may apply to the court to set aside certain dispositions made by the company before winding-up. These are referred to as "impeachable transactions" and include the following:

Dispositions without value

Voidable preference

Undue preferences

Collusive dealings

**Compromise (creditors' scheme of arrangement)**

No. Prior transactions are more likely to be challenged in the context of liquidation or business rescue proceedings. Please see further detail in response to this question under "Liquidation."

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