Deon Prins

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LL.M (Commercial Law)

Priority issues in business rescue

Helena Stoop (Supervisor)

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I hereby declare that I have read and understood the regulations governing the submission of LL.M dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

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1. Introduction

The status of a creditor has always been vitally important in South African law. Our law contains numerous provisions – amongst others in the law of insolvency – to protect creditors’ rights, that is, the ability of creditors to collect from debtors what they are owed. Traditionally secured creditors – that is, creditors who hold some form of real security for their claim – rank higher in priority when it comes to repayment of their claims by a defaulting debtor, both in individual and collective debt enforcement procedures, and as such are, in the vast majority of cases, able to recover full or at least partial repayment of their claims.

Business rescue was introduced into South African law with the commencement of the new Companies Act, \(^1\) which became effective on 1 May 2011. Business rescue is a relatively new collective debt enforcement mechanism applicable to corporate debtors. There has been considerable uncertainty with regards to the interpretation of some of its provisions, mainly due to important concepts and terms not being defined. This uncertainty has extended to the provisions dealing with the extension of finance to a corporate debtor after commencement of the business rescue proceedings (so-called ‘post-commencement finance’) and the ranking of priority of creditors of such corporate debtor during the business rescue proceedings.

This dissertation will firstly focus on explaining the concept of business rescue, with specific emphasis on post-commencement finance. The relevant provisions relating to post-commencement finance will be interpreted along the lines of recent principles governing statutory interpretation. An apparent conflict in the interpretation of these provisions will be identified through specific reference to the limited number of judicial pronouncements on this subject matter to date.

In attempting to resolve the apparent conflict in the interpretation of the relevant provisions, this dissertation will then briefly consider the background to business rescue in South Africa. The Companies Act itself shall be considered, with specific

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\(^1\) Act 71 of 2008, hereinafter ‘the Companies Act’.
reference to its stated purpose and objects, along with a look at the historical development of the specific provisions in question.

A brief review will then be undertaken of the role and function of real security in a collective debt enforcement procedure such as business rescue under South African law, with specific reference to the existing distribution rules in insolvency law. A comparative review of relevant foreign jurisdictions will then be carried out. This dissertation will conclude by providing a suggested approach to the interpretation of the ranking of priorities under business rescue.

2. Post-commencement finance and the protection of property interests under business rescue

The concept of ‘business rescue’ was introduced into the South African law in Chapter 6 of the Companies Act. The scheme of the new business rescue provisions in the Companies Act was described as follows:2

‘The general philosophy permeating through the business rescue provisions is the recognition of the value of the business as a going concern rather than the juristic person itself. Hence the name “business rescue” and not “company rescue”. This is in line with modern trend [sic] in rescue regimes. It attempts to secure and balance the opposing interests of creditors, shareholders and employees. It encapsulates a shift from creditors’ interests to a broader range of interests. The thinking is that to preserve the business coupled with the experience and skill of its employers may, in the end prove to be a better option for creditors in securing full recovery from the debtor. To rescue the business, provision is made to “buy into” the procedure without fear of losing such investment in an ailing company by securing repayment as a preferential repayment as part of the “post-commencement financing”. Post-commencement creditors are thus offered a “super-priority” as an incentive to assist the company financially.’

Between 1 May 2011 and 31 March 2014, a total of 1 338 business rescue notices were filed,3 which equates to an average of just over 38 business rescue notices being filed per month. A significant proportion of these filings were invalid

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2 Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others, Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and Others [2012] ZAGPJHC 12 (hereinafter ‘Oakdene Square Properties’) at para 12.

and declared nullities – a total of 217, or 16.22 per cent. However, it must be noted that the majority of these invalid filings occurred during 2011 and 2012, when business rescue was still in its infancy, and for the three months from January to March 2014, only three filings out of 94 (or 3.2 per cent) were invalid.\(^4\)

This leaves a total of 1,121 cases where business rescue proceedings have commenced; of those, a total of 349 entities have had their business rescue proceedings ended. Of those, 129 matters may be considered successful in the sense that a Notice of Substantial Implementation of a Business Rescue Plan\(^5\) has been filed with the Companies and Intellectual Property Commission (CIPC), a success rate of about 37 per cent.\(^6\) Of course, the argument could also be made that only 11.5 per cent of the total number of business rescue proceedings that had commenced up until 31 March 2014 had resulted in a successful outcome by that date; a recent report compiled for the CIPC estimated the success rate for business rescues up until 31 July 2014 at only 9.4 per cent.\(^7\)

It has been observed that post-commencement finance ‘is potentially one of the most important, and most problematic, aspects of a successful business rescue model.’\(^8\) In order to induce potential funders to provide post-commencement finance, such post-commencement creditors are offered a ‘super-priority’ over all pre-commencement unsecured claims against the company.\(^9\) Du Preez’s 2012 survey of business rescue practitioners and financiers\(^10\) identified that concerns and uncertainty

\(^4\) Ibid

\(^5\) Companies and Intellectual Property Commission Form CoR 125.3.

\(^6\) Op cit n 3.


\(^10\) Du Preez, *The status of post-commencement finance for business rescue in South Africa* (MBA research project, University of Pretoria (2012)).
regarding the priority ranking of post-commencement finance\textsuperscript{11} was a major obstacle to the provision thereof. The ranking of the claims of creditors in business rescue has been a fairly contentious and much debated topic.\textsuperscript{12}

The ranking of creditors’ claims in terms of business rescue proceedings is regulated by Section 135 of the Companies Act; more specifically, s 135(3) which provides as follows:

‘After payment of the practitioner’s remuneration and expenses referred to in section 143, and other claims arising out of the costs of the business rescue proceedings, all claims contemplated –

(a) In subsection (1) [amounts due and payable to employees after commencement of business rescue proceedings] will be treated equally, but will have preference over –

(i) all claims contemplated in subsection (2) [general third-party post-commencement finance], irrespective of whether or not they are secured; and
(ii) all unsecured claims against the company; or

(b) in subsection (2) will have preference in the order in which they were incurred over all unsecured claims against the company.’

In October 2011, Stein\textsuperscript{13} published what was described as the ‘first sustained treatment’ of the Companies Act.\textsuperscript{14} This publication also provided, to the author’s knowledge, the first interpretation of the ranking of creditors’ claims under business rescue:\textsuperscript{15}

‘Creditors’ claims will therefore rank in the following order of preference –

\textsuperscript{11} Ibid at p 116.


\textsuperscript{13} Stein & Everingham The New Companies Act Unlocked: A Practical Guide (Cape Town (2011)).

\textsuperscript{14} Ibid p v, in the Foreword by Dennis Davis.

\textsuperscript{15} Ibid at 421.
1. the practitioner for remuneration and expenses, and other persons (including legal and other professionals) for costs of the business rescue proceedings;  
2. employees for any remuneration which became due and payable after business rescue proceedings began;  
3. secured lenders or other creditors for any loan or supply made after business rescue proceedings began (ie, post-commencement finance);  
4. unsecured lenders or other creditors for any loan or supply made after business rescue proceedings began (ie, post-commencement finance);  
5. secured lenders or other creditors for any loan or supply made before business rescue proceedings began;  
6. employees for any remuneration which became due and payable before business rescue proceedings began; and  
7. unsecured lenders or other creditors for any loan or supply made before business rescue proceedings began.’

As pointed out by Henochsberg, this ranking does not seem to be in accordance with the wording of s 135, since there is no reference in that section to claims by pre-commencement secured lenders.17

The first judgment to deal with the ranking of creditors’ claims in business rescue - Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd and Another18 - was delivered in May 2013, two years after the Companies Act came into effect. Kgomo J’s judgment specifically refers to Stein’s abovementioned book,20 and sets out the ranking of creditor claims as follows:21

‘Claims rank in the following order of preference:

1. The practitioner, for remuneration and expenses, and other persons (including legal and other professionals) for costs of business rescue proceedings.  
2. Employees for any remuneration which became due and payable after business rescue proceedings began.

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16 Henochsberg on the Companies Act 71 of 2008, p 478(10)-(12).

17 However, the equivalent section in the Companies Bill 2007 did refer to such claims – see 4.2 below.

18 (13/12406) [2013] ZAGPJHC 109 (10 May 2013). Hereinafter referred to as ‘Merchant West’.

20 Ibid at para 20 fn 10.

21 Ibid at para 21. It has been argued that Kgomo J’s remarks in this paragraph were obiter dicta.
3. Secured lenders or other creditors for any loan or supply made after business rescue proceedings began, ie post-commencement finance.
4. Unsecured lenders or other creditors for any loan or supply made after business rescue proceedings began, ie post-commencement finance.
5. Secured lenders or other creditors for any loan or supply made before business rescue proceedings began.
6. Employees for any remuneration which became due and payable before business rescue proceedings began.
7. Unsecured lenders or other creditors for any loan or supply made before business rescue proceedings began.’

It is clear that the ranking set out above is a verbatim copy of the ranking suggested earlier by Stein. This same ranking was again repeated, verbatim, shortly thereafter in a judgment by the same judicial officer – Redpath Mining South Africa (Pty) Ltd v Marsden and Others. However, the Redpath Mining judgment specifically referred to the protection of secured creditors’ rights as being regulated by section 134(3).

Section 134(3) reads as follows:

‘If, during a company’s business rescue proceedings, the company wishes to dispose of any property over which another person has any security or title interest, the company must –

(a) 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 or title interest; and

(b) promptly –

(i) 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

(ii) provide security for the amount of those proceeds, to the reasonable satisfaction of that other person.’

An approach that provides on the one hand for the protection of the rights and interests of pre-commencement secured creditors, but on the other hand provides for

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22 Op cit n 13, at p 421.

23 (18486/2013) [2013] ZAGPJHC 148 (14 June 2013), at para 60. Hereinafter referred to as ‘Redpath Mining’.

24 Ibid at para 56.
a ranking that allows for an unqualified ‘carving out’ of such secured interests, is untenable. It therefore appears that the ranking of creditors provided in *Merchant West* and *Redpath Mining* is incorrect.

It is trite that the wording of Chapter 6 of the Companies Act protects pre-commencement secured claims in a number of instances. Examples of this would include the requirement – in most cases\(^{25}\) – of obtaining the consent of a person with a security or title interest over property of the company if that property is to be sold during business rescue proceedings and then promptly paying the proceeds from that sale to that person;\(^{26}\) and the ability for post-commencement finance to be secured to a lender by utilizing any asset of the company to the extent that it is not yet otherwise encumbered\(^{27}\). However, it would appear that the interpretation of s 135(3) in the *Merchant West* and *Redpath Mining* judgments makes it clear that pre-commencement secured claims rank after the claims of both secured and unsecured post-commencement financiers,\(^{28}\) and a conflict arises with regards to the simultaneous interpretation of sections 134 and 135.

The Constitution provides that, when interpreting any legislation, and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights.\(^{29}\) Furthermore, the Bill of Rights protects the right to property\(^{30}\) and specifically provides that no one may be deprived of property except in terms of law of general application, and no law may permit arbitrary deprivation of property.\(^{31}\) Section 25 does not define ‘property’,

\(^{25}\) The exception being instances where the anticipated proceeds from the sale of the encumbered asset are sufficient to settle in full the claim by the secured creditor concerned.

\(^{26}\) S 134(3).

\(^{27}\) S 135(2).

\(^{28}\) Levenstein and Becker op cit 12.

\(^{29}\) Section 39(2) of the Constitution of the Republic of South Africa, 1996 (hereinafter ‘the Constitution’).

\(^{30}\) Section 25 of the Constitution.

\(^{31}\) S 25(1) of the Constitution.
other than stating that it is ‘not limited to land’, but it would appear that constitutional case law supports a wide enough definition of ‘property’ to include real security rights, that is, real rights in property.

The primary function of the constitutional protection against arbitrary deprivation of property has been described as ‘striking a proportionate balance’ between the two functions of protecting existing private property rights and serving the public interest. Whether there has been a ‘deprivation’ depends on the extent of ‘any interference with the use, enjoyment or exploitation of private property’, that is, involves ‘some deprivation in respect of the person having title or right to or in the property concerned’. There must be ‘substantial interference or limitation that goes beyond the normal restrictions on property use or enjoyment found in an open and democratic society’ to constitute deprivation; and such deprivation will be arbitrary when the law of general application imposing that deprivation does not ‘provide

32 S 25(4)(c) of the Constitution.

33 See First National Bank of SA Ltd v/a Wesbank v Commissioner, South African Revenue Service and Another; First National Bank of SA Ltd v/a Wesbank v Minister of Finance [2002] ZACC 5 at para 5 (arguing that assigning a comprehensive definition to the term ‘property’ is impossible and unwise and not necessary in that case) (hereinafter ‘FNB v CSARS’); see also National Credit Regulator v Opperman and Others [2012] ZACC 29 (which declared the right to restitution of money paid on the basis of unjustified enrichment as ‘property’ for the purposes of section 25); Laugh It Off Promotions CC v SAB International (Finance) BV v/a Sagmark International (Freedom of Expression Institute as Amicus Curiae) [2005] ZACC 7 and Phumelela Gaming and Leisure Ltd v Gründlingh and Others [2006] ZACC 6 (accepting a trade mark to be ‘property’); Law Society of South Africa and Others v Minister for Transport and Another [2010] ZACC 25 (which went so far as assuming that even a personal claim for loss of earning capacity or support is ‘property’).

34 FNB v CSARS at para 50.


sufficient reason for the particular deprivation in question or is procedurally unfair.'

Sufficient reason, inter alia, is to be determined by ‘evaluating the relationship between means employed, namely the deprivation in question, and ends sought to be achieved, namely the purpose of the law in question.’

The Constitutional Court recently confirmed that giving words in a statute their ordinary grammatical meaning is a fundamental tenet of statutory interpretation, unless doing so results in an absurdity. It has furthermore been confirmed in a number of decisions by our highest court that our Constitution requires a purposive approach to statutory interpretation, which approach had been followed prior to the introduction of the Constitution to a certain extent in the courts. As explained by Schreiner JA more than sixty years ago:

‘Certainly no less important than the oft repeated statement that the words and expressions used in a statute must be interpreted according to their ordinary meaning is the statement that they must be interpreted in light of their context. But it may be useful to stress two points in relation to the application of this principle. The first is that “the context”, as here used, is not limited to the language of the rest of the statute regarded as throwing light of a dictionary kind on the part to be interpreted. Often of more importance is the matter of the statute, its apparent scope and purpose, and, within limits, its background.’

37 FNB v CSARS at para 100.

38 Ibid


41 In the Bertie van Zyl judgment mentioned in n 68, Mokgoro J referred to Jaga v Dönges NO and Another; Bhana v Dönges NO and Another 1950 (4) SA 653 (A) at 662-3 and University of Cape Town v Cape Bar Council and Another 1986 (4) SA 903 (AD).

42 In his dissenting judgment in Jaga v Dönges, op cit 39, at 662-3, which was cited with approval by Ngcobo J in the Bato Star judgment, op cit 37.
The Constitutional Court has held that ‘[t]he emerging trend in statutory construction is to have regard to the context in which the words occur, even where the words to be construed are clear and unambiguous.’ Wallis JA recently set out the current approach to statutory interpretation as follows:

‘Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighted in the light of all these factors. The process is objective, not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. Judges must be alert to, and guard against, the temptation to substitute what they regard as reasonable, sensible or businesslike for the words actually used. To do so in regard to a statute or statutory instrument is to cross the divide between interpretation and legislation; in a contractual context it is to make a contract for the parties other than the one they in fact made. The “inevitable point of departure is the language of the provision itself”, read in context and having regard to the purpose of the provision and the background to the preparation and production of the document.’

It is clear that the common-law rule of excluding evidence of the circumstances surrounding the adoption of a statute no longer applies in our law, and courts may now refer to acceptable background material, which will include policy documents.

In attempting to resolve the apparent conflict in the interpretation of sections 134 and 135, it is therefore necessary to briefly consider the background to the ‘preparation and production’ of statutory provisions dealing with business rescue in South Africa.

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43 Bato Star supra para 90.


45 Currie & De Waal The Bill of Rights Handbook, 6th ed (Cape Town (2013)), at p 143.
3. Background to business rescue in South Africa

Judicial management was first introduced in South Africa in 1926, one of the first jurisdictions in the world to introduce a statutory corporate rescue mechanism. Judicial management was left largely unchanged in the Companies Act, 1973 and was subject to strong criticism.

During the late 1980s the South African Law Commission (the ‘Commission’) reviewed the South African law of insolvency under Project 63. Six interim reports were submitted and seven working papers were subsequently published for comments, and in 1996 a draft Insolvency Bill and Explanatory Memorandum was published as Discussion Paper 66 and called for comments. An Insolvency

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46 Via the Companies Act, 1926 (Act 46 of 1926).


48 Olver ‘Judicial Management – A Case For Law Reform’ 1986 Tydskrif vir Hededendaagse Romeins-Hollandse Reg 84, who notes that the success rate of judicial management in avoiding an ultimate liquidation was less than 20 per cent of the limited number of companies who were eligible to make use of the procedure. For more background on the academic criticism against judicial management, see Burdette A framework for corporate insolvency law reform in South Africa (LLD thesis, University of Pretoria (2002)) and Loubser ‘Judicial management as a business rescue procedure in South African corporate law’ 2004 SA Merc LJ 137.


50 The principal statute of the law of insolvency was (and still is) the Insolvency Act, 1936 (Act 24 of 1936). The 1936 Act replaced the Insolvency Act, 1916 (Act 32 of 1916) but did not amend it drastically. Since its date of commencement on 1 July 1936, the Insolvency Act has been amended by fifty subsequent statutes and proclamations.


53 The response was overwhelming – a total of 28 commentators produced more than 350 pages of comments.
Project Committee\textsuperscript{54} was appointed to assist with the investigation; at the same time the Standing Advisory Committee on Company Law\textsuperscript{55} (SACCL) agreed to investigate a number of subjects, including judicial management, and it was agreed that the project committee would take into account the results of the SACCL’s research in so far as it related to insolvency.\textsuperscript{56}

The SACCL authorised the Centre for Advanced Corporate and Insolvency Law (CACIL) at the University of Pretoria to embark on a project\textsuperscript{57} to attempt to merge existing liquidation provisions\textsuperscript{58} into the draft Insolvency Bill, which resulted in a Draft Bankruptcy Bill which was submitted for discussion at a symposium in 1998.\textsuperscript{59} At the time there had been a move towards general acceptance of a business rescue culture in comparable systems.\textsuperscript{60}

\textsuperscript{54} This project committee was chaired by the Honourable Justice R H Zulman, and the researcher responsible for investigation was Advocate M B Cronje. This project committee held a total of 27 meetings during the course of its investigation.

\textsuperscript{55} Created in terms of section 18 of the Companies Act, 1973.

\textsuperscript{56} The 1996 draft Insolvency Bill and explanatory memorandum, paragraph 5.1.2.

\textsuperscript{57} The project leader and researcher was Mr D A Burdette of the University of Pretoria.

\textsuperscript{58} As contained in the Companies Act, 1973 (Act 61 of 1973) and the Close Corporations Act, 1984 (Act 69 of 1984).

\textsuperscript{59} Burdette, \textit{Final Report Containing Proposals on a Unified Insolvency Act Part 1: Final Report and Explanatory Memorandum} (2000), paras 1.3 and 1.4. The working document was discussed at a symposium held at Procforum (Transvaal Law Society) on 23 October 1998 which was attended by approximately 210 delegates. It is of interest to note that Burdette notes that a ‘clear, unanimous signal emanated from the symposium – South Africa needs, and wants, a unified system of insolvency law which is contained in one consolidated piece of legislation’.

At this symposium, a paper on business rescue was delivered by Rajak and Henning which ‘gave an excellent exposition of…judicial management’ and ‘made valid suggestions in respect of who should oversee a process of business rescue.’ A paper was also delivered by Smits in which he suggested that South Africa should consider a business rescue regime similar to that provided for under Chapter 11 of the United States Bankruptcy Code.

The symposium was followed by a series of workshops dealing with the technical intricacies of the Bill. Three proposals for the future of South African business rescue emerged: the first, by Kloppers, argued for the retention of judicial management, but with reforms; while the second proposal by Nel and a third proposal based on the model suggested by Smits both argued for automatic stays as their basis and were debtor-friendly in approach.

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62 Burdette op cit note 8, fn 195.
63 Anthony J. Smits was a South African who had emigrated to the United States and had become an international bankruptcy expert working for a Connecticut-based law firm called Hebb & Gitlin.
64 His paper was later published as Smits ‘Corporate administration: a proposed model’ 1999 De Jure 85. Smits realized that the provisions of Chapter 11 of the US Bankruptcy Code could not simply be wholesale transplanted to South African law and suggested adapting them to the South African context.
65 Burdette, op cit note 8, para 1.5. These workshops were held at the University of Pretoria from 7 to 10 December 1998, and were attended by approximately sixty delegates.
66 Pieter Kloppers of the University of Stellenbosch.
68 Basil Nel, at the time the head of PriceWaterhouseCoopers’ liquidation division. Nel’s initial proposals were described as ‘radical’ but he eventually compiled a ‘more tempered version’ in conjunction with insolvency practitioner Chris Edeling – Burdette op cit note 8, para 24.2.
69 Legislative provisions based on Smits’s proposals were drafted by Burdette and finalized with the assistance of Michael R. Rochelle, a Texas-based bankruptcy attorney – Burdette op cit note 8, para 24.4.
The Insolvency Project Committee’s draft Insolvency Bill and CACIL’s draft Bankruptcy Bill were then discussed at a conference\(^\text{70}\) the following year. The three proposals for business rescue mentioned above were also discussed, but no consensus could be reached on which one was appropriate\(^\text{71}\). It was suggested\(^\text{72}\) that a report combining the proposals of both the Insolvency Project Committee and CACIL be lodged with the Commission to ensure the consideration of a unified Insolvency Act by the Commission in early 2000\(^\text{73}\).

Since no proposal could be finalized in respect of business rescue provisions\(^\text{74}\), CACIL’s final report instead suggested retaining judicial management with some minor amendments\(^\text{75}\) ‘until a proper business rescue regime can be implemented.’\(^\text{76}\)

The Honourable Justice Mahomed submitted the Commission’s report on the review of the law of insolvency and the draft Insolvency Bill\(^\text{77}\) to the Minister of Justice and Constitutional Development on 23 February 2000. The draft Bill, under Chapter 24, provided for the retention of judicial management with the minor

\(^{70}\) Burdette, op cit note 8, paras 1.6 and 1.7. The conference took place at Eskom Conference Centre on 6 October 1999, for which 230 delegates registered.

\(^{71}\) Ibid para 24.6.

\(^{72}\) The suggestion was made by Judge of Appeal Ralph Zulman and Professor Michael Katz, with the approval of the delegates present – Burdette op cit note 8, para 1.12.

\(^{73}\) Due to time constraints it proved impossible to have a joint report ready for distribution in time, and instead references to various working papers were utilised.

\(^{74}\) Burdette op cit note 8, para 24.9.

\(^{75}\) These amendments included making judicial management applicable not just to companies but to other juristic persons as well, and amending the burden of proof for obtaining a judicial management order from ‘reasonable probability’ to ‘reasonable possibility’.

\(^{76}\) Burdette op cit note 8, para 24.10.

amendments suggested by CACIL. In 2003\textsuperscript{78} the Cabinet of South Africa approved the draft Insolvency and Business Recovery Bill, the name given to the Bill when it was envisaged that business rescue provisions for corporate entities would be included as part of a unified Insolvency Act.\textsuperscript{79}

The Insolvency and Business Recovery Bill was submitted to Parliament for consideration during the 2003 session, but consideration thereof was delayed as a result of uncertainty about the department responsible for developing modern business rescue provisions.\textsuperscript{80}

In July 2003 the Department of Trade and Industry\textsuperscript{81} (‘DTI’) convened a Local and International Roundtable on Company Law Reform in Johannesburg, which constituted the official launch of the new company law reform process in South Africa.\textsuperscript{82} The intention of the DTI was to undertake a comprehensive overhaul – or ‘fundamental revamp’ - of South African company law, and to do so by formulating a policy framework to guide the reform process.\textsuperscript{83} A relatively simple process was

\textsuperscript{78} This was announced in the statement on the Cabinet meeting of 5 March 2003: http://www.gcis.gov.za/content/newsroom/media-releases/cabinet-statements/statement-cabinet-meeting-5-march-2003 Accessed on 7 January 2015.

\textsuperscript{79} Calitz ‘Some thoughts on state regulation of South African insolvency law’ 2011 44 De Jure 290, fn 87.


\textsuperscript{81} By way of Astrid Ludin, then Deputy Director-General of the Consumer and Corporate Regulation Division (CCRD) within the Department of Trade and Industry (DTI).

\textsuperscript{82} Mongalo (ed), Modern Company Law for a Competitive South African Economy (2010) xiv. There were eleven original participants at this roundtable: Astrid Ludin; James J. Hanks Jr. (a US commercial lawyer); Professor Samuel C. Thompson (UCLA School of Law); Nigel Boardman (a UK-based corporate and commercial solicitor); Dines Gihwala (chairman of Hofmeyr Herbstein and Gihwala); Judge Basheer Waglay (a Judge in the Labour Court and a member of the SACCL); Nicky Newton-King (Deputy CEO of the Johannesburg Stock Exchange); Judge Lucy Mailulu (Judge of the High Court and vice-chairperson of the SACCL); Tshepo H. Mongalo (project manager); Norman Manoim (Competition Tribunal); and Dr. Alistair Ruiters (Director-General of the DTI).

\textsuperscript{83} Ibid xiv-xv.
clearly envisaged by the DTI, as evidenced by the following statement made at the
roundtable:

‘Corporate law reform processes that have been adopted around the world have
been quite different from the one we envisage in South Africa. What we envisage is a
fairly simple process in terms of formulating a policy and legislation without a lot of
committees. I think in many countries, in the UK recently, there have been task teams
and various committees appointed. That is not what we envisage here, but the
emphasis will be on consultation on both the policy document and on the
legislation.’

The policy formulation process was led by the project manager who was assisted
by a chief policy adviser and a chief drafter. In addition to this core of three, there
were six working groups that each had its own specific priority area to consider.
The working groups recommended broad principles to the core team for drafting of
provisions; once the principles were formulated they were circulated for comment to
specialists divided into a local reference team and an international reference team.
Broad principles for company law reform had emerged from the initial roundtable;
one of these was that judicial management was failing the local economy.

In May 2004 the DTI’s company law reform process had formulated its policy
framework. Policy on corporate rescue and judicial management included the

84 Mongalo op cit 81 xv at fn 6.

85 Judge Dennis Davis.

86 Phillip Knight, a Canadian plain-language drafting expert and legal practitioner.

87 Mongalo op cit 81 at xvi.

88 Many members of the local reference team were also members of the SACCL – supra.

89 The international reference team included four from the United States, three from the United
Kingdom and one from Australia.

90 Mongalo op cit 81 at xvii; Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd (2001) 1 All
SA 223 (C) at 238, where Josman J referred to judicial management as ‘a system which has barely
worked since its initiation in 1926’.

91 DTI, South African Company Law for the 21st Century: Guidelines for Corporate Law Reform
(2004).
following direct quote from the paper delivered by Rajak and Henning at the symposium on insolvency law reform six years previously:

‘...all modern corporate rescues are united on one matter, the absence which, possibly more than anything else, has helped to bring South Africa’s judicial management to its present perceived impotence. This is the recognition that the agreed plan by which the future relations between the debtor and its creditors will be governed may well include the reduction of the debtor’s overall indebtedness. To insist, as the South African rescue provision does, that a protective moratorium is available only where “there is a reasonable probability that if [the debtor] is placed under judicial management, it will be able to pay its debts or to meet its obligations”, is to ignore the well-nigh universal reality of creditors being prepared, for their own benefit, to forgive part of the debt. It is frequently the case that a creditor will benefit far more from having the debtor back in the market place than from suing the debtor into extinction. A radically new rescue provision should provide a mechanism under which a specified majority of creditors can approve a plan under which the debtor may emerge from protection and resume normal commercial dealings.’

The policy document also indicated that ‘[t]his recommendation will be taken into consideration in the law review process in order to create a system of corporate rescue appropriate to the needs of a modern South African economy. In particular, the provisions of the US Chapter 11 will be considered. It must further be tested against the work already done by the Department of Justice in the proposed Insolvency and Business Rescue [sic] Bill.’ (Emphasis added.)

The above-mentioned guidelines were published in the Government Gazette on 23 June 2004. This was followed by a series of public consultation sessions in all nine provinces, along with the guidelines being tabled within the National Economic Development and Labour Council’s Trade and Industry Chamber for consideration.

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92 See note 59.

93 Ibid, at para 4.6.2.

94 Op cit n 90 at paragraph 4.6.2.


96 Mongalo op cit n 81 at xxii.
Following the report by a Ministerial Committee of Enquiry into the Liquidations Industry appointed by the Minister of Justice and Constitutional Development\textsuperscript{97}, the appointment of an Inter-Departmental Task Team was approved by Cabinet in June 2005\textsuperscript{98} to report, among others, on business rescue and judicial management. At the time, both the Department of Justice and Constitutional Development (in the form of its insolvency law reform project) and the Department of Trade and Industry (in the form of its company law reform project) were involved in proposing a new business rescue regime; the task team concluded that the DTI was best-placed to take responsibility for business rescue.\textsuperscript{99}

The first exposure draft of the new Companies Bill was finalized in April 2006; after internal consultation within the DTI, focus group consultations with relevant stakeholders in the labour, business and civil society sectors took place in July 2006, whereupon the Bill was finalized for submission to the Minister of Justice and Cabinet to obtain approval for publication.\textsuperscript{100} The Companies Bill, 2007 (the ‘2007 Bill’) was approved by Cabinet for public comment in February 2007\textsuperscript{101} and published shortly thereafter.\textsuperscript{102}

\begin{flushleft}
\textsuperscript{97} The Committee was appointed to investigate ‘systemic problems’ within the liquidation industry.


\textsuperscript{99} By this time the DTI’s Company Law Reform Project had already started the process of legislative drafting of the new Companies Bill, which included new business rescue provisions.

\textsuperscript{100} Mongalo op cit n 81 at xxiii.

\textsuperscript{101} See the statement on the Cabinet meeting of 7 February 2007: \url{http://www.gcis.gov.za/content/newsroom/media-releases/cabinet-statements/statement-cabinet-meeting-7-february-2007} Accessed on 7 January 2015.

\textsuperscript{102} Companies Bill, 2007 GN 166 in Government Gazette No 29630 of 12 February 2007. The business rescue provisions were contained under Chapter 6 of the Bill.
\end{flushleft}
The publication of the 2007 Bill elicited considerable comment. The DTI instructed the drafting team to revise the 2007 Bill in a manner that would continue to give effect to the identified policy guidelines, but address all the issues and concerns that had been raised as far as practically possible.

A revised Bill – the Companies Bill, 2008 – was introduced into Parliament during June 2008 and formally published by the DTI for general comment as Bill 61 of 2008. Following public hearings within the Portfolio Committee on Trade and Industry, the National Assembly adopted the new Companies Bill with minor amendments on 19 November 2008 as the Companies Bill B61D of 2008. The Bill was eventually assented to by the President and gazetted on 9 April 2009.

Loubser has pointed out that, despite the substantial changes to South African corporate law as a result of the new Companies Bill – including the introduction of a brand-new business rescue mechanism – the Bill was introduced into Parliament only sixteen months after the publication of the first draft of the Bill, and was approved barely five months later. When the 1973 Companies Act was promulgated, it was the result of a detailed report by the Van Wyk de Vries Commission explaining and substantiating every single proposed provision; this is not the case for the 2008 Companies Act and Loubser was proved to be rightly concerned that there would be problems of interpretation, especially relating to the business rescue provisions.

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103 Mongalo op cit n 81 at xxiv notes that, aside from oral submissions received during public consultation sessions, the DTI received over 3,000 written pages in comments.


106 Mongalo op cit n 81 at xxv.


109 Of course, it was the stated intention of the DTI to keep the law reform process relatively simple.

110 Loubser op cit 107 at 6.
This view has been endorsed by the Supreme Court of Appeal in several recent judgments requiring interpretation of business rescue provisions.111

4. The Companies Act

The preamble to the Act describes its purpose as, inter alia, ‘to provide for efficient rescue of financially distressed companies’. It furthermore states that one of the purposes of the Act is to ‘provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders.’112

There is no explanatory memorandum to the Companies Act, but an explanatory memorandum was provided by the DTI to the 2007 Companies Bill. This memorandum referred to the five-point statement of economic growth objectives113 which had been set out in the DTI’s 2004 policy document,114 which proposed ‘that company law should promote the competitiveness and development of the South African economy’ by:

1. Encouraging entrepreneurship and enterprise development, and consequently, employment opportunities by –
   (a) simplifying the procedures for forming companies; and
   (b) reducing costs associated with the formalities of forming a company and maintaining its existence.
2. Promoting innovation and investment in South African markets and companies by providing for –
   (a) flexibility in the design and organization of companies; and
   (b) a predictable and effective regulatory environment.

111 See, inter alia, Leach JA in African Banking Corporation of Botswana v Kariba Furniture Manufacturers & others [2015] ZASCA 69 at para 43 (“I do not believe it is unfair to comment that many of the provisions of the Act relating to business rescue, and s 153 in particular, were shoddily drafted and have given rise to considerable uncertainty.”) and Wallis JA in Panamo Properties (Pty) Ltd v Nel and Another NNO [2015] ZASCA 76 at para 1 (“These commendable goals are unfortunately being hampered because the statutory provisions governing business rescue are not always clearly drafted. Consequently they have given rise to confusion as to their meaning and provided ample scope for litigious parties to exploit inconsistencies and advance technical arguments aimed at stultifying the business rescue process or securing advantages not contemplated by its broad purpose.”).

112 S 7(k) of the 2008 Companies Act.

113 Op cit n 101 at page 3.

114 Op cit n 94.
3. Promoting the **efficiency** of companies and their management.
4. Encouraging **transparency** and high standards of corporate governance.
5. Making company law compatible and harmonious with best practice **jurisdictions internationally**.\(^{115}\)

The explanatory memorandum to the 2007 Bill furthermore states that, ‘in accordance with the reform objectives and specific goals, Chapter 6 proposes replacing the existing regime of judicial administration of failing companies with a modern business rescue regime, largely self-administered by the company, under independent supervision within constraints set out in the chapter, and subject to court intervention at any time on application by any of the stakeholders. In particular, the Chapter recognizes the interests of shareholders, creditors and employees, and provides for their respective participation in the development and approval of a business rescue plan.’\(^{116}\)

The Companies Act does not define ‘stakeholder’, but Chapter 6 does define an ‘affected person’ of the company in question as being either a shareholder, a creditor, or an employee\(^\text{117}\) (or representative of the employee such as a registered trade union).\(^\text{118}\) ‘Relevant stakeholders’, as referred to in section 7 of the Act, therefore appears to include any and all affected persons. By inference, then, a stated purpose of the Act is to provide for the efficient rescue and recovery of financially distressed companies in a manner that balances the rights and interests of affected persons, being shareholders, creditors and employees.

In the 2007 Companies Bill, the Chapter 6 business rescue provisions were contained in sections 130 to 157. For the purposes of this dissertation, sections 137 (protection of property interests) and 138 (post-commencement finance) are relevant. The 2008 Companies Bill, tabled in the National Assembly sixteen months later, saw the business rescue provisions then being contained in sections 128 to 155. The relevant provisions mentioned above were renumbered to sections 134 and 135; both sections were considerably amended from the earlier bill. The final form of the Companies Act, as promulgated, included further, minor, amendments. With the promulgation of the Companies Amendment Act 3 of 2011, a number of provisions

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\(^{115}\) Ibid at p 10.

\(^{116}\) Op cit n 101 at p 13.

\(^{117}\) Directors of the company would be included under the definition of employees.

\(^{118}\) Section 128(1)(a).
were, yet again, amended. Section 134(3) remained unchanged, but section 135(3) – the provision dealing with the priority of claims under business rescue proceedings – was amended, although not materially.  

4.1 Protection of property interests

In its first guise as section 137 under the 2007 Companies Bill, the protection of property interests clause read as follows:

(1) ...
(2) ...
(3) If, during a company’s business rescue proceedings, the company wishes to dispose of any property over which another person has any security or title interest, the company must promptly -

  (a) pay to that person the sale proceeds attributable to that property;  
      or

  (b) provide security for the amount of those proceeds, reasonably satisfactory to that person.

The 2008 Companies Bill saw the relevant provision renumbered to section 134, which now read as follows:

(1) ...
(2) ...
(3) If, during a company’s business rescue proceedings, the company disposes of any property over which another person has any security or title interest, the company must –

  (a) 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 or title interest; and

119 The only difference being the substitution of the word ‘costs’ with the word ‘expenses’ in s 135(3).
(b) promptly –

(i) 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

(ii) provide security for the amount of those proceeds, to the reasonable satisfaction of that other person.

The final form of the provision remained effectively unchanged.\textsuperscript{120} It would appear that the provision was amended by the legislature to provide even greater protection of the interests of a person holding a security or title interest in the property of a company by adding the requirement of obtaining prior consent from that person should the anticipated proceeds of the disposal of that asset be insufficient to fully discharge the indebtedness protected by that security or title interest.\textsuperscript{121}

As pointed out by Henochsberg,\textsuperscript{122} no definition of the term ‘security or title interest’\textsuperscript{123} as used in subsection 134(3) is provided by the Companies Act. However, the winding-up of a company subsequent to business rescue proceedings is contemplated as a possibility in several sections of Chapter 6.\textsuperscript{124} The transitional arrangements to the Companies Act provide that, despite the repeal of the 1973 Companies Act, Chapter 14 of that Act\textsuperscript{125} continues to apply with respect to the

\textsuperscript{120} The phrase ‘the company disposes’ was substituted with the phrase ‘the company wishes to dispose’.

\textsuperscript{121} S 134(3)(a).

\textsuperscript{122} Op cit n 16 at p 478(8).

\textsuperscript{123} The term ‘security interest’ is defined in § 51A of the Australian Corporations Act 2001 as, amongst others, ‘a charge, lien or pledge’.

\textsuperscript{124} Inter alia, ss 129(6), 131(8(a), 132(2)(a)(ii), 135(4), 140(4), 141(2)(a)(ii), 145(4)(b), 150(2)(a)(iii), 150(2)(b)(vi), 155(3)(a)(iii) and 155(3)(a)(vi).

\textsuperscript{125} Chapter 14 consists of sections 337 to 426 and deals with the winding-up of companies.
winding-up and liquidation of companies under the Companies Act.\textsuperscript{126} Section 342 of the 1973 Companies Act provides that, in every liquidation of a company ‘the assets shall be applied in payment of the costs, charges and expenses incurred in the winding-up and...the claims of creditors as nearly as possible as they would be applied in payment of the costs of sequestration and the claims of creditors under the law relating to insolvency...’\textsuperscript{127}

The Insolvency Act\textsuperscript{128} defines ‘security’ as follows: ‘[i]n relation to the claim of a creditor of an insolvent estate, means property of that estate over which the creditor has a preferent right by virtue of any special mortgage,\textsuperscript{129} landlord’s legal hypothec, pledge or right of retention.’\textsuperscript{130} This definition is uncontroversial and has been part of the South African law for a considerable period of time. It is submitted that there are no impediments to equating ‘security or title interest’, as used in s 134(3), to this definition of ‘security’, and to refer to indebtedness protected by such security or title interest as a secured claim. By the same reasoning, where indebtedness is not likewise protected by such security or title interest, it would constitute an unsecured claim.

The above interpretation in the context of business rescue was approved by Fourie J in \textit{SARS v Beginsel}\textsuperscript{131} where the learned judge confirmed that the categorization of creditors into secured and unsecured ‘is uncontentious and well-

\textsuperscript{126} Item 9 of Schedule 5 to the Companies Act 71 of 2008.

\textsuperscript{127} S 342(1) of the 1973 Companies Act.

\textsuperscript{128} Act 24 of 1936, hereinafter ‘the Insolvency Act’.

\textsuperscript{129} ‘Special mortgage’ is defined to mean a mortgage bond hypothecating any immovable property or a notarial mortgage bond hypothecating specially described movable property in terms of section 1 of the Security by Means of Moveable Property Act, 1993 (Act 57 of 1993), or such a notarial mortgage bond registered before 7 May 1993 in terms of section 1 of the Notarial Bonds (Natal Act, 1932 (Act 18 of 1932), but excluded any other mortgage bond hypothecating moveable property – section 2 sv of the Insolvency Act 24 of 1936.

\textsuperscript{130} Section 2 sv of the Insolvency Act 24 of 1936.

\textsuperscript{131} \textit{The Commissioner for the South African Revenue Service v Beginsel and Others} (15080/12) [2012] ZAWCHC 194 (31 October 2012), hereinafter ‘\textit{SARS v Beginsel}’.
known in legal parlance. Secured creditors are those who hold security over the company’s property, such as a lien or mortgage bond. Unsecured creditors are those whose claims are not secured, including concurrent creditors. The unsecured creditors are either preferent or concurrent creditors. The term “preferent creditor”, used in the wide sense, refers to any creditor who has a right to receive payment before other creditors. To this extent, a secured creditor also qualifies as a preferent creditor. However, the term “preferent creditor” is normally reserved for a creditor whose claim is not secured, but who nevertheless ranks above the claims of concurrent creditors (whose claims are also unsecured). Such preferent creditors are commonly referred to as “unsecured preferent creditors” and are mentioned in sections 96-102 of the Insolvency Act.\footnote{Ibid at paragraph 25.}

Furthermore, the Insolvency Act defines ‘preference’ as follows: ‘in relation to any claim against an insolvent estate, means the right to payment of that claim out of the assets of the estate in preference to other claims; and ‘preferent’ has a corresponding meaning.’\footnote{Ibid} The intended practical effect of section 134(3) would therefore appear to be analogous to the practical effect of a secured claim in terms of the Insolvency Act.

4.2 Post-commencement finance

In the 2007 Companies Bill, section 138 was the relevant provision dealing with post-commencement finance and read as follows:

\begin{enumerate}
\item To the extent that money becomes due and payable by a company to an employee during the company’s business rescue proceedings, but is not paid to the employee –
\begin{enumerate}
\item the money is deemed to be post-commencement financing, irrespective whether it has been approved by other creditors; and
\item will be paid in the order of preference set out in subsection (3)(a).
\end{enumerate}
\end{enumerate}

\footnote{Ibid}
(2) Any amount of financing obtained by the company during its business rescue proceedings, other than as contemplated in subsection (1), will be paid in the order of preference set out in subsection 3(b).

(3) After payment of the supervisor’s remuneration and costs referred to in section 146, and other claims arising out of the costs of the business rescue proceedings, all claims contemplated –

(a) in subsection (1) will have preference in the order in which they were incurred over –

(i) all claims contemplated in subsection (2); and

(ii) all secured and unsecured claims against the company; or

(b) in subsection (2) will have preference in the order in which they were incurred over all unsecured claims against the company.

(4) If business rescue proceedings are superseded by a liquidation order, the preference conferred in terms of this section will remain in force except to the extent of any claims arising out of the costs of liquidation.

By the time that the Companies Act had come into effect, the relevant provision had been renumbered to section 135 and had been significantly amended:

(1) To the extent that any remuneration, reimbursement for expenses or other amount of money relating to employment becomes due and payable by a company to an employee during the company’s business rescue proceedings, but is not paid to the employee –

(a) the money is regarded to be post-commencement financing; and

(b) will be paid in the order of preference set out in subsection 3(a).

(2) During its business rescue proceedings, the company may obtain financing other than as contemplated in subsection (1), and any such financing –

(a) may be secured to the lender by utilizing any asset of the company to the extent that it is not otherwise encumbered; and

(b) will be paid in the order of preference set out in subsection (3)(b).

(3) After payment of the practitioner’s remuneration and expenses referred to in section 143, and other claims arising out of the costs of the business rescue proceedings, all claims contemplated –

(a) In subsection (1) will be treated equally, but will have preference over –
(i) all claims contemplated in subsection (2), irrespective whether or not they are secured; and
(ii) all unsecured claims against the company; or
(b) in subsection (2) will have preference in the order in which they were incurred over all unsecured claims against the company.

(4) If business rescue proceedings are superseded by a liquidation order, the preference conferred in terms of this section will remain in force, except to the extent of any claims arising out of the costs of liquidation.

It is of interest to note the historical evolution of this provision. First and foremost it appears that, per the 2007 Companies Bill, so-called deemed employee post-commencement finance was specifically intended to have priority in the order in which they were incurred over general third-party post-commencement claims – irrespective of whether secured or not – as well as all (other) secured and unsecured claims against the company. Subsection 3(a) refers only to the priority of deemed employee post-commencement finance, whereas subsection 3(b) refers only to the priority of general third-party post-commencement finance. On a proper construction of section 138 of the 2007 Companies Bill, it would appear that the ranking of priorities in business rescue was intended to be as follows:

1. The practitioner’s remuneration and expenses;
2. Deemed employee post-commencement finance in the order in which they were incurred;
3. Secured pre-commencement claims;¹³⁵
4. Secured post-commencement finance;
5. Unsecured post-commencement finance in the order in which they were incurred;
6. Employee (unsecured) claims for remuneration that arose prior to business rescue proceedings commencing;¹³⁶

¹³⁴ Or what appears to embrace the principle of prior in tempore, potior in iure.

¹³⁵ This is due to subsection 3(b) specifically referring only to unsecured claims.

¹³⁶ Due to section 147(1) of the 2007 Companies Bill, which identifies employees in respect of such pre-commencement claims as a ‘senior unsecured creditor’ of the company.
7. Other unsecured pre-commencement claims.

The provision was substantially amended in the 2008 Company Bill. More specifically, subsection 3(a) – which defines the priority of deemed employee post-commencement finance – was amended to include only unsecured claims (that is, the reference to ‘secured claims’ in subsection 3(a)(ii) was deleted). This amendment is significant, in that it implies that the legislature specifically intended to remove secured (pre-commencement) claims from the operation of the subsection.\footnote{137} Furthermore, by the time that the Act was promulgated, subsection 3(a) had been further amended in that deemed employee post-commencement claims would be treated equally,\footnote{138} and not paid in the order in which they were incurred.

A construction of the final version of section 135 as set out in the Companies Act appears to indicate that the ranking of priorities in business rescue should be as follows:

1. The practitioner’s remuneration and expenses;\footnote{139}
2. Secured pre-commencement claims;
3. Deemed employee post-commencement finance, \textit{pari passu};
4. Secured post-commencement finance;
5. Unsecured post-commencement finance in the order in which they were incurred;
6. Employee (unsecured) claims for remuneration that arose prior to business rescue proceedings commencing;\footnote{140}
7. Other unsecured pre-commencement claims.

\footnote{137}{It would appear that the credit provider lobby must have provided considerable opposition to the initial wording.}

\footnote{138}{Which can be equated to the principle of \textit{pari passu} repayment in insolvency law.}

\footnote{139}{There is little doubt that the practitioner’s remuneration constitute an absolute super-priority as a result of the wording of s 143(5), which provides that, to the extent that the practitioner’s remuneration and expenses are not fully paid, the practitioner’s claim for those amounts will rank in priority before the claims of all other secured and unsecured creditors.}

\footnote{140}{Section 144(2) of the 2008 Companies Act.}
The special protection afforded to employees’ claims is of course consistent with stated policy grounds\(^{141}\) and is not new to South African insolvency law,\(^ {142}\) nor is it without precedent in foreign jurisdictions.\(^ {143}\) In France, the super-preference employee claim is limited to the last 60 working days’ pay (subject to a maximum of twice the wage used as the basis for calculating social security contributions per working month) plus the allowance for leave not taken (up to 30 days), plus also (where applicable) compensation in lieu of notice.\(^ {144}\) There is no similar qualification of the scope of deemed employee post-commencement finance in the Companies Act.\(^ {145}\) Furthermore, the ‘super-preference’ in favour of employee claims in France does not have priority over secured claims, with the following reason provided: in the case of a secured claim, the asset pledged as security for the repayment of the debt is – factually or notionally – repossessed. The secured creditor asserts vis-à-vis the employee creditor not so much a preference based on his secured claim, but rather on the right to retain (even if only notionally) an object which – theoretically – remains in his possession.\(^ {146}\)

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\(^ {141}\) See, for example, Claassen J in *Oakdene Square Properties* at para 15.

\(^ {142}\) See section 98A of the Insolvency Act.

\(^ {143}\) Yemin and Bronstein (eds) *The protection of workers’ claims in the event of the employer’s insolvency* (1991) Labour-Management Relations Series 76, International Labour Organisation, pp 29-32 at 30 which indicates that so-called ‘super-preferences’ in favour of employees have been introduced in France, Spain, Brazil, Ecuador, Mexico, Peru, Benin, Chad, Côte d’Ivoire, Gabon, Guinea, Algeria, Tunisia and the Philippines. It should be noted that the scope of such super-preference is limited in almost all of these jurisdictions up to a maximum benchmark.

\(^ {144}\) Ibid at p 31.

\(^ {145}\) A commentator on the Commission’s review of the law of insolvency stated that a super-preference for employee claims cannot be supported since such claims can potentially reach a magnitude where it will simply wipe out the secured assets, which would work against the entire credit supply scheme and have a devastating effect on the economy: see *Report on the review of the law of insolvency*, op cit n 76, at para 80.19.

In 1984 the Commission recommended that employee claims for salary and commission for a period of three months immediately before sequestration, leave pay for a period of 21 days and bonus be considered a preferent unsecured claim, ie paid in preference to other unsecured creditors but not secured claims.\textsuperscript{147} This recommendation was substantially implemented by the legislature through the insertion of section 98A in the Insolvency Act in 1998.\textsuperscript{148}

Finally, it is clear that the ranking of priority in terms of section 135(3) survives the conversion of business rescue proceedings into subsequent liquidation proceedings\textsuperscript{149} except to the extent of any claims arising out of the costs of liquidation.\textsuperscript{150}

It is worth noting that, under judicial management, the pre-commencement creditors had the discretion, at a meeting convened by the judicial manager, to consent to any post-commencement liabilities incurred by the judicial manager enjoying a preference in the order in which they were incurred over all unsecured claims against the company, except claims arising out of the costs of judicial management.\textsuperscript{151} Where the creditors consented to such preference in favour of post-commencement claims, that preference survived the conversion of judicial management into subsequent liquidation proceedings.\textsuperscript{152}

\begin{itemize}
\item \textsuperscript{147} \textit{Commission’s report on the review of the law of insolvency}, op cit n 75, at paragraph 80.1. At the time – 1984 – this was also limited to a maximum of R3 000 per employee, which adjusted for inflation is the equivalent of approximately R40 000 today.
\item \textsuperscript{148} Section 98A was inserted by section 2 of the Judicial Matters Second Amendment Act 122 of 1998.
\item \textsuperscript{149} Section 135(4).
\item \textsuperscript{150} These would refer specifically to costs of realisation outlined in section 89 of the Insolvency Act.
\item \textsuperscript{151} Section 435(1)(a) of the 1973 Companies Act.
\item \textsuperscript{152} Ibid s 435(1)(b).
\end{itemize}
5. Comparative law review on priority of post-commencement finance

Professor Michael Katz – who had been involved in discussions around the reform of business rescue since at least 1998 – described the 2008 Companies Act as follows:

‘For the first time in South Africa companies’ legislation we have not been rooted to English company law. In fact the New Companies Act is not anchored in the Company law of any foreign jurisdiction. The New Companies Act represents the best of breed, borrowing in each particular concept from the best in the particular jurisdiction. In certain respects we have home-grown innovations. All of this combines to enable South Africa to take its place amongst the best of company law jurisdictions.’

That being said, as has been pointed out earlier, the DTI policy document published in 2004 indicated that, as far as business rescue was concerned, ‘[i]n particular, the provisions of the US Chapter 11 will be considered.’ The international reference team involved in the drafting of the 2008 Companies Act included experts from the United States, the United Kingdom, and Australia; it would appear logical that the applicable corporate insolvency law regimes from those jurisdictions, and in particular the United States, heavily influenced the development of the provisions relating to business rescue in South Africa. The Supreme Court of Appeal in a very recent judgment confirmed that our business rescue regime is adapted from similar concepts in foreign jurisdictions such as the United States and United Kingdom.

It would also appear logical that best-practice recommendations by international bodies such as the United Nations Commission on International Trade Law (UNCITRAL) and the World Bank would have played at least some role during the process of policy formulation and drafting of provisions by participants in South Africa’s company law reform process. After all, ‘[m]aking company law compatible

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154 Op cit n 90.

and harmonious with best practice jurisdictions internationally’ was one of the identified objectives of the company law reform process.156

5.1 The United States

Bankruptcy in the United States is regulated by the Bankruptcy Code157 which allows for two corporate insolvency procedures, namely liquidation (which is governed by Chapter 7) and reorganization (which is governed by Chapter 11).158 Under Chapter 7 liquidation, the business ceases trading, all assets are sold and proceeds distributed to creditors. Chapter 11 allows any business159 to file a petition160 for protection against creditors and continue carrying on trading activities as a going concern while reorganizing or restructuring the business. In the majority of cases the corporation remains in possession of property upon which creditors have liens or similar security interests during this process, and becomes known as a debtor in possession.161 The debtor in possession effectively becomes the trustee162 and is empowered to operate the debtor’s business.163 A key feature of Chapter 11 proceedings is the proposal and confirmation of a plan of reorganization; the debtor in possession has a period of exclusivity to file a plan, after which ‘parties in

156 See n 114 above.
157 Title 11 of the United States Code.
158 Chapter 11 was introduced by the Bankruptcy Reform Act of 1978.
159 The procedure is open to corporations, partnerships, sole proprietorships and even individuals (although rare, since Chapter 13 of the Bankruptcy Code provides a reorganization process for most private individuals).
160 It should be noted that original and exclusive jurisdiction over all cases arising under the Bankruptcy Code is held by specialist United States bankruptcy courts, which are created under Article I of the United States Constitution and function as units of the United States district courts.
161 11 U.S.C. § 1101 defines ‘debtor in possession’ to mean the debtor unless a separate trustee has been appointed for cause.
interest¹⁶⁴ may file a plan.¹⁶⁵ A plan needs to be approved by a court and all creditors to become binding; if at least one class of creditors does not agree with the plan, there is the possibility of having the plan ‘crammed down’, that is, involuntarily imposed on the dissenting creditors.¹⁶⁶

Chapter 11 features an automatic stay¹⁶⁷ which prevents creditors from carrying out debt collection procedures against the debtor in possession. So-called executory contracts¹⁶⁸ may either be affirmed or rejected by the debtor in possession, but such affirmation or rejection is subject to court approval.¹⁶⁹

The Bankruptcy Code distinguishes between situations where creditors are over-secured – that is, the value of the collateral held as security exceeds the amount of the claim – and under-secured – that is, the value of the collateral held as security is lower than the amount of the claim.¹⁷⁰ A debtor may bifurcate an under-secured claim into two components – secured to the extent of the value of the collateral and unsecured in respect of any remaining balance.¹⁷¹ To the extent that a creditor is over-secured, such secured creditor is entitled to interest on such claim, along with any reasonable fees, costs, or charges.¹⁷² The trustee may recover from property securing a claim all reasonable, necessary costs and expenses of preserving, or

¹⁶⁴ Being the debtor, the trustee, a creditor’s committee, an equity security holders’ committee, a creditor, an equity security holder, or any indentured trustee.

¹⁶⁵ 11 U.S.C. § 1121. The debtor in possession has a period of 120 days’ exclusivity to file a plan.


¹⁶⁸ Contracts which at the time of filing the petition for Chapter 11 bankruptcy have not yet been fully executed, in that both parties still have obligations to perform.


disposing of, such property to the extent of any benefit to the holder of such claim.\footnote{173} Furthermore, a secured creditor in Chapter 11 has a right to the value of her claim, and not necessarily the right to receive the collateral itself.\footnote{174}

All forms of bankruptcy in the United States – including Chapter 7 liquidation – follow the same ranking of priorities, which is set out in Chapter 5. When property is sold that is subject to a lien or security interest, the proceeds are paid to that secured creditor after all necessary costs and expenses of preserving and disposing of the property have been paid. To the extent that there is a balance remaining after the secured creditor’s claim has been settled, that balance is used to settle, on a pro rata basis, various categories of unsecured creditors in terms of a scheme of priority that is primarily set out in § 507.\footnote{175}

\footnote{173} 11 U.S.C. § 506(c).

\footnote{174} In \textit{Wright v. Union Central Life Ins. Co.} 311 U.S. 273, 278 (1940) the Supreme Court unequivocally held that a secured creditor has a constitutionally protected right up to the value of the mortgaged property; however, ‘[t]here is no constitutional claim of the creditor to more than that.’

\footnote{175} § 507(a) identifies and ranks ten categories or rungs of priority unsecured claims, as follows:

\textit{First,} certain claims due to domestic and child support obligations (which are mostly irrelevant in Chapter 11 cases);

\textit{Second,} administrative expenses incurred during the bankruptcy, which includes the costs of professionals, employee salaries and wages, as well as litigation expenses during the Chapter 11 proceedings;

\textit{Third,} certain costs incurred in involuntary bankruptcy cases in the ordinary course of business after the commencement of the case but before the earlier of the appointment of a trustee and the order for relief;

\textit{Fourth,} employee claims, subject to a maximum of $10,000, for salary, commissions and other benefits earned within 180 days immediately preceding the bankruptcy;

\textit{Fifth,} claims for contributions to an employee benefit plan, subject to a cap, incurred within the 180 days immediately preceding the bankruptcy;

\textit{Sixth,} certain claims of grain farmers and fishermen;
This so-called ladder of priorities means that each level – or rung – of priority must be settled in full before the next lowest rung of priority may be repaid.

Despite the strong protection provided to secured creditors under Chapter 11, it should be noted that secured creditors may lose their preference over unsecured creditors in certain circumstances. These include a situation where a court confirms a plan of reorganization that varies the default distribution rules, as well as where a judge may, in appropriate cases, ‘subordinate’ one claim to another.\(^\text{176}\)

The debtor in possession may obtain unsecured credit and incur unsecured debt in the ordinary course of business to pay for allowable administrative expenses,\(^\text{177}\) which means that such debtor in possession finance will enjoy priority over virtually all other unsecured claims against the debtor. A debtor in possession may also approach the court to authorize obtaining unsecured credit or to incur unsecured debt for any other purpose outside the ordinary course of business, which will then have

\[^{\text{Seventh}}\text{, deposits made pre-petition by individuals, subject to a maximum of $1,800 per individual, in respect of leases or purchases for personal, family or household use;}\]

\[^{\text{Eighth}}\text{, certain unsecured tax claims by governmental units;}\]

\[^{\text{Ninth}}\text{, certain unsecured claims related to commitments for capital maintenance owed to a Federal depository institutions regulatory agency;}\]

\[^{\text{Tenth}}\text{, tort claims for death or personal injuries resulting from the operation of a motor vehicle or vessel by the debtor while intoxicated.}\]

Only after all of these priority claims have been paid will general unsecured creditors be paid on a \textit{pro rata} basis.

\(^{176}\) 11 U.S.C. § 510(c) provides that a court may, after notice and a hearing, under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or order than any lien securing such a subordinated claim be transferred to the estate.

\(^{177}\) 11 U.S.C. § 364. The allowable administrative expenses are listed under § 503(b)(1) and includes the actual and necessary costs and expenses of preserving the estate including wages, salaries, and commissions for services rendered after commencement of the bankruptcy, as well as certain taxes.
the same priority as an allowed administrative expense.\textsuperscript{178} If the debtor in possession is unable to obtain unsecured credit to pay for allowable administrative expenses, the court may authorize the debtor in possession to obtain finance by allowing the security of a lien on property that is not yet encumbered, or otherwise allowing a further lien on property that is already encumbered.\textsuperscript{179}

The court may even authorize the debtor in possession to obtain finance on the basis of a lien that is senior, ie ranks first, to existing liens on a property.\textsuperscript{180} This is a so-called ‘priming lien’, but may only be authorised by a court if it is satisfied that (a) the debtor in possession is unable to obtain such finance otherwise; and (b) that there is adequate protection of the interest of the existing secured creditor whose lien is being primed. The burden of proof on the issue of adequate protection of the existing mortgagee is on the debtor in possession.

It is clear that a priming lien is the most aggressive approach allowed in the Bankruptcy Code to provide liquidity to a debtor in possession, and that only a small number of cases would satisfy both conditions to allow the court to authorize it. One of the most notable US cases dealing with priming liens for debtor in possession finance was the case of \textit{In re Olde Prairie Block Owner}.\textsuperscript{181} In this case Judge Schmetterer indicated that ‘adequate protection’ requires that a secured lender receives compensation or something of value during the duration of the bankruptcy proceedings to protect it against any erosion in value as a result of depreciation, dissipation or any other cause, including the actual value of the priming debtor in possession loan. Adequate protection, it was stated, can take many forms, including for example periodic cash payments, replacement liens, liens on unencumbered property, or an ‘equity cushion’, that is, the amount by which a secured lender is over-secured. However, in \textit{Olde Prairie Block} it was pointed out that a large equity cushion is not a ‘debtor’s piggy bank and the uses contemplated for the new loan

\textsuperscript{178} 11 U.S.C. § 364(b).

\textsuperscript{179} 11 U.S.C. § 364(c).

\textsuperscript{180} 11 U.S.C. § 364(d).

\textsuperscript{181} \textit{In re Olde Prairie Block Owner, LLC}, 448 B.R. 482 (Bankr. N.D. Ill. 2011).
must have serious likelihood of benefitting the property and advancing the purposes of reorganization. A priming lien without such a showing would impose an unwarranted burden on the secured creditor if reorganization fails.' Also, ‘allowing a priming lien should be considered with caution to avoid transferring the entrepreneurial risk of failure by Debtor’s investors and principals onto the secured creditor.’

It has been held in a number of cases that an under-secured creditor may have her lien primed in certain circumstances where she can be provided with adequate protection by a debtor in possession by preserving and maximizing the value of the collateral during the Chapter 11 proceedings.\(^{182}\)

It is clear that there is considerable protection of secured creditors’ interests under US bankruptcy law. Secured claims are generally paid in priority to unsecured claims, and even where a debtor in possession successfully applies to court for authorization to allow a new funder to leap-frog an existing secured creditor’s priority to the proceeds of specific collateral, the interest of that existing mortgagee is still protected by requiring the debtor in possession to prove that there is adequate protection for such existing mortgagee.

### 5.2 England and Wales

Corporate insolvency proceedings in England and Wales is regulated by the Insolvency Act 1986, as modified by the Enterprise Act 2002.

\(^{182}\) *In re Hubbard Power & Light*, 202 B.R. 680 (Bankr. E.D.N.Y. 1996) (where it was held that the secured creditor was adequately protected since the first priority priming lien would allow the debtor to resume operations, which would allow its assets to increase in value); *In re 495 Cent. Park Ave. Corp.*, 136 B.R. 626 (Bankr. S.D.N.Y. 1992) (holding that an existing mortgagee was adequately protected since the value of the debtor’s property would increase as a result of renovations funded by the first priority priming loan); *In re Yellowstone Mountain Club, LLC.*, No. 08-61570, 2008 WL 5875547 (Bankr. D. Mont. 2008) (where it was held that the debtor in possession loan would preserve the value of the secured creditors’ collateral and in fact enhance it to an extent greater than the amount of the proposed priming loan).
English corporate insolvency law provides for a procedure called administration.\(^{183}\) There are three ways a company can be placed into administration. The first is through an out-of-court appointment by the holder of a floating charge over the whole or substantially the whole of the company’s property.\(^{184}\) A floating charge is a rather unique English security interest that is a charge over a class of assets present and future, where the class changes from time to time, and where the party in whose favour the floating charge operates is only able to attach the assets in that class at a specific time – called the ‘crystallisation’ - at which time the charge becomes a fixed charge. While the charge is floating, the debtor is able to freely utilise the assets falling within that class and may carry on its business in the ordinary way.\(^{185}\)

The second way a company can enter administration is if the company itself makes an out-of-court appointment of an administrator on giving prior notice to a qualified floating charge holder.\(^{186}\) A third way is for an administrator to be appointed by the court on application by the company itself, the directors of the company, one or more creditors, or the designated officer of a magistrate’s court, or a combination of these.\(^{187}\) The court may only make the order if it is satisfied that the company is or is likely to become unable to pay its debts, and that the administration order is reasonably likely to achieve the purposes of administration. The purposes of administration include either rescuing the company as a going concern, or achieving a better result for the company’s creditors as a whole than would be likely if the company were wound up, or realizing property in order to make a distribution to one

\(^{183}\) The English law also provides for two other insolvency reorganization procedures – ‘company voluntary arrangement’ as well as schemes of arrangement under the Companies Act, which are both effectively privately-negotiated agreements between the company and its creditors concern rescheduling of debt, payment holidays etc

\(^{184}\) Schedule B1 Insolvency Act 1986 para 14.

\(^{185}\) Re Yorkshire Woolcombers Association [1903] 2 Ch 284.

\(^{186}\) Schedule B1 Insolvency Act 1986 paras 22 and 26.

\(^{187}\) Ibid, para 12.
or more secured or preferential creditors.\textsuperscript{188} An administrator is an officer of the court, whether or not she is appointed by the court.\textsuperscript{189}

The effect of a company going into administration is a moratorium on insolvency proceedings\textsuperscript{190} and on other legal processes, including steps taken to enforce security over the company’s property.\textsuperscript{191} Proceedings to enforce security over the company’s property may only be taken with the consent of the administrator or with the permission of the court.

The administrator is vested with very broad powers to run the debtor’s business, and may do anything necessary or expedient for the management of the affairs, business and property of the company.\textsuperscript{192} Once appointed, the administrator must require one or more relevant persons to provide her with a statement of the affairs of the company.\textsuperscript{193} The administrator must then prepare a statement of proposals for achieving the purpose of administration, which is presented to an initial creditors’ meeting for approval.\textsuperscript{194}

An administrator’s statement of proposals may not include any action which affects the right of a secured creditor of the company to enforce her security, would result in a preferential debt of the company being paid otherwise than in priority to its non-preferential debts, or would result in one preferential creditor of the company being paid a smaller proportion of his debt than another, unless the creditor in question consents thereto.\textsuperscript{195} Where property is subject to a security other than a

\begin{itemize}
\item \textsuperscript{188} Ibid, para 3.
\item \textsuperscript{189} Ibid, para 5.
\item \textsuperscript{190} Ibid, para 42.
\item \textsuperscript{191} Ibid, para 43.
\item \textsuperscript{192} Ibid, para 59.
\item \textsuperscript{193} Ibid, para 47.
\item \textsuperscript{194} Ibid, paras 49 and 51.
\item \textsuperscript{195} Ibid, para 73.
\end{itemize}
floating charge, the administrator may apply to court for permission to dispose of property subject to such security as if it were not subject to the security, provided that the disposal of the property would be likely to promote the purpose of administration in respect of the company. Furthermore, upon such disposal the debt secured by that property must be settled with the net proceeds.\footnote{196}

The administrator of a company has the power to raise or borrow money and grant security therefor over the property of the company.\footnote{197} It is therefore clear that an administrator may raise post-commencement finance, and may do so by providing security to potential post-commencement finance providers. However, the administrator is not able to provide priority to a post-commencement finance provider, unless the consent of the existing secured creditor is obtained.\footnote{198}

McCormack\footnote{199} indicates that during parliamentary debates on the reform of corporate insolvency reform in the United Kingdom, the government resisted providing super-priority status to post-commencement finance providers after the administration process had commenced, since it was afraid it would encourage the funding of rescue proposals irrespective of the commercial viability thereof since lenders would be guaranteed a return. McCormack also argues that the Insolvency Act could be read in a way so as to permit new financing arrangements during administration to take priority over an existing floating charge (but not over existing fixed charges or other security).\footnote{200}

\footnote{196} Ibid, para 71.

\footnote{197} Schedule 1 of the Insolvency Act 1986, item 3.

\footnote{198} That is, the secured creditor consents to a subordination agreement whereby first lien status is granted to the post-commencement funder who would otherwise be secondary to that secured creditor.


\footnote{200} Ibid at 207.
5.3 Australia

Chapter 5 of the Corporations Act 2001 provides for ‘voluntary administration’. The object of voluntary administration is to maximize the chances of the company – or as much of its business – continuing in existence; or, if it is not possible for the company or its business to continue in existence, results in a better return for the company’s creditors and members than would result from an immediate liquidation of the company.

An administrator may be appointed in a number of ways if it is believed that the company either is or will become insolvent: either by the company itself, by a liquidator, or by a secured creditor of the company having security over the whole, or substantially the whole, of a company’s property. No authorization by the court is required.

The company’s property is protected against creditors during administration by, amongst others, an automatic stay of proceedings.

An administrator, once appointed, is given extremely wide powers – she may perform any function and exercise any power that the company or any of its officers could perform or exercise if the company were not under administration. While a company is under administration, the management stays in place but is only able to

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201 See Corporations Act 2001, Part 5.3A, which consists of sections 435 to 451.

202 § 435A Corporations Act 2001. It will be noted that these objectives are virtually identical to the goals of business rescue as defined in section 128(1)(b)(iii) of the Companies Act 2008.


206 § 440D Corporations Act 2001. The automatic stay can only be circumvented by either obtaining written consent from the administrator, or with the leave of the court.

perform or exercise a function or power with the administrator’s written approval.\textsuperscript{208} Only the administrator is able to deal with the company’s property while the company is under administration.\textsuperscript{209}

The first order of affairs for an administrator is to investigate the company’s affairs and to consider possible courses of action.\textsuperscript{210} The administrator acts in the creditors’ interests and must decide on either executing a deed of company arrangement (essentially a restructure plan to be presented to creditors), or taking the company out of administration, or having it liquidated. The administrator then convenes a meeting of creditors at which the company’s future is decided upon.\textsuperscript{211}

Where property of a company in administration which is subject to a security interest is sold, the secured creditor is entitled to retain the proceeds of the sale as follows:\textsuperscript{212}

1. If the net proceeds of sale equals or falls short of the debt secured by the security interest, the secured creditor is entitled to retain the full net proceeds.
2. If the net proceeds of sale exceeds the debt secured by the security interest, the secured party must pay the excess proceeds to the administrator of the company.

There is no mention of post-commencement finance under Chapter 5, but due to the extremely wide powers given to an administrator, it is clear that she can raise finance after being appointed. However, the Australian statute makes no provision for any form of priority in favour of post-commencement finance.

\textsuperscript{208} § 437C Corporations Act 2001.
\textsuperscript{209} § 437D Corporations Act 2001.
\textsuperscript{210} § 438A Corporations Act 2001.
\textsuperscript{211} § 439A Corporations Act 2001.
\textsuperscript{212} § 441EA Corporations Act 2001.
5.4 The UNCITRAL Legislative Guide on Insolvency Law

The United Nations Commission on International Trade Law (UNCITRAL) is a subsidiary body of the United Nations General Assembly, and prepares international legislative texts for use by member States in modernising commercial law and non-legislative texts for use by commercial parties in negotiating transactions.\(^\text{213}\)

In 1999 a proposal was made by UNCITRAL to undertake a project to provide a legislative guide on insolvency law, specifically corporate insolvency, which culminated in the adoption of a legislative guide on insolvency law in June 2004.\(^\text{214}\)

The purpose of the UNCITRAL legislative guide is to ‘assist the establishment of an efficient and effective legal framework to address the financial difficulty of debtors. It is intended to be used as a reference by national authorities and legislative bodies when preparing new laws or regulations or reviewing the adequacy of existing laws and regulations. The advice provided in the Guide aims at achieving a balance between the need to address the debtor’s financial difficulty as quickly and efficiently as possible and the interests of the various parties directly concerned with that financial difficulty, principally creditors and other parties with a stake in the debtor’s business, as well as with public policy concerns.’\(^\text{215}\)

One of the key objectives of an effective and efficient insolvency law identified by the Guide includes the recognition of existing creditor rights and establishment of clear rules for the ranking of priority claims.\(^\text{216}\) The Guide recommends that priorities should be based upon commercial bargains and not reflect social and political concerns that have the potential to distort the outcome of insolvency; instead, priorities that are not based on commercial bargains need to be minimized.

\(^\text{213}\) South Africa was elected as a member of UNCITRAL at the fifty-eighth session of the United Nations’ General Assembly in 2003, with a membership term eventually running from 2004 to 2013.


\(^\text{215}\) Ibid at para 1.

\(^\text{216}\) The Guide at 13.
The Guide recognises the need for post-commencement finance, and identifies the purpose of provisions on post-commencement finance to:

(a) Facilitate finance to be obtained for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the assets of the estate;

(b) Ensure appropriate protection for the providers of post-commencement finance; and

(c) Ensure appropriate protection for those parties whose rights may be affected by the provisions of post-commencement finance.\(^\text{217}\)

The Guide recommends that the law should establish a priority for post-commencement finance that should at least ensure repayment of post-commencement finance ahead of ordinary pre-commencement unsecured creditors.\(^\text{218}\) Furthermore, the law should enable post-commencement finance providers to obtain security for repayment of their claims, including security on any unencumbered assets of the company, including assets acquired post-commencement, or junior or lower-priority security on already-encumbered assets of the company.\(^\text{219}\) Furthermore, the law should specify that a security interest over the assets of the company to secure post-commencement finance does not have priority ahead of existing, pre-commencement security interest over the same assets unless the consent of the existing secured creditor(s) thereto is obtained.\(^\text{220}\) However, where the existing secured creditor does not consent, the court may authorize the post-commencement finance provider having a higher priority than the existing secured creditor, provided very specific conditions are satisfied, including:

1. Allowing the existing secured creditor the opportunity to make representations to the court;

\(^{217}\) The Guide at 118.

\(^{218}\) The Guide, Recommendation 64 at 119.

\(^{219}\) The Guide, Recommendation 65 at 119.

2. The debtor company proving that it cannot obtain finance in any other way; and
3. The interests of the existing secured creditor being protected.\(^{221}\)

Furthermore, it is recommended that where reorganization proceedings are subsequently converted to liquidation, any priority accorded to post-commencement finance during the reorganization proceedings should survive such conversion and continue to be applied in the liquidation.\(^{222}\)

5.5 The World Bank Principles

The World Bank originally developed the *Principles for Effective Insolvency and Creditor Rights Systems* (the ‘Principles’) in 2001. The Principles are ‘a distillation of international best practice on design aspects’ of insolvency and creditor rights systems.\(^{223}\)

The Principles recommend, amongst others, that the priority of secured creditors in their collateral should be upheld and, absent the secured creditor’s consent, its interest in the collateral should not be subordinated to other priorities granted in the course of the insolvency proceedings, and distributions to secured creditors should be made as promptly as possible.\(^{224}\) After distributions to secured creditors from their collateral and the payment of claims related to administrative expenses, proceeds available for distribution should be distributed *pari passu* to the remaining body of unsecured creditors, unless there are compelling reasons to justify giving priority status to a particular class of claims;\(^ {225}\) however, employees are a vital part of an

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\(^{221}\) The Guide, Recommendation 67 at 119. Effectively, this recommendation is to adopt substantially the same procedure as the priming lien under US law.

\(^{222}\) The Guide, Recommendation 68 at 119.


\(^{224}\) The Principles, C12.2, at 19.

\(^{225}\) The Principles, C12.3, at 19.
enterprise, and careful consideration should be given to balancing the rights of employees with other creditors.\textsuperscript{226}

\textbf{5.6 Observations}

It is clear that the corporate insolvency regimes in the jurisdictions referred to have very strong protections in favour of pre-commencement secured creditors. There are of course specific instances where a secured creditor may see her real security being eroded in favour of a post-commencement finance provider, but such cases are the exception and require judicial adjudication to become effective, along with proof from the debtor that the existing secured creditor being prejudiced will be adequately protected in some way or manner.

\textbf{6. Distribution rules in South African insolvency}

As confirmed in \textit{SARS v Beginsel},\textsuperscript{227} the categorization of creditors into secured and unsecured creditors is uncontroversial and accepted in our law. In order to be a secured creditor, a creditor must hold security\textsuperscript{228} over property of the debtor at the time that the debtor is sequestrated or liquidated. In the vast majority of cases security is provided in the form of a mortgage bond that hypothecates immovable property. Secured creditors’ claims are generally paid out of the proceeds from the realisation of the assets that they hold as security.

Insolvency is a collective debt enforcement process, and once a debtor is sequestrated or liquidated a \textit{concursus creditorum} arises that effectively freezes the rights of creditors as at the date of liquidation. As Innes CJ put it over a century ago:

\begin{quote}
‘\textit{The hand of the law is laid upon the estate, and at once the rights of the general body of creditors have to be taken into consideration. No transaction can thereafter be entered into with regard to estate matters by a single creditor to the }
\end{quote}

\textsuperscript{226} The Principles, C12.4, at 19.

\textsuperscript{227} Op cit n 130.

\textsuperscript{228} As defined in section 2 \textit{sv} Insolvency Act 1936, ‘in relation to the claim of a creditor of an insolvent estate, means property of that estate over which the creditor has a preferent right by virtue of any special mortgage, landlord’s legal hypothec, pledge or right of retention’.
prejudice of the general body. The claim of each creditor must be dealt with as it existed at the issue of the order.\textsuperscript{229}

It should be noted that in South African law individuals and trusts are sequestrated by order of court and a trustee is appointed to manage the insolvent’s affairs. In the case of a company or close corporation, the insolvent is liquidated and a liquidator (or liquidators) appointed to manage the insolvent’s affairs and wind up the corporate entity.

Unsecured creditors, being creditors that do not hold security over property of the debtor at the time that the debtor is sequestrated or liquidated, are generally divided in South African insolvency law into preferent creditors and concurrent creditors. Preferent\textsuperscript{230} creditors are preferred by virtue of specific statutory provisions that elevate their claims in priority above those of general concurrent creditors. It should be noted that the Commission indicated in its report on the review of the law of insolvency\textsuperscript{231} that such provisions preferring 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.’\textsuperscript{232} Indeed, there has long been an argument that statutory preferences in favour of certain unsecured creditors should be removed on the basis that all unsecured creditors should be treated equally and fairly.\textsuperscript{233} However, there have also been opinions raised that certain unsecured creditors, for example involuntary unsecured creditors such as victims of delict, should have some form of stake in real security.\textsuperscript{234}

\textsuperscript{229} Walker v Syfret NO 1911 AD 141 at 166.

\textsuperscript{230} Preferent is defined in section 2 sv Insolvency Act 1936, ‘in relation to any claim against an insolvent estate, means the right to payment of that claim out of the assets of the estate in preference to other claims.’

\textsuperscript{231} Op cit n 76.

\textsuperscript{232} Ibid at para 7.3.

\textsuperscript{233} Du Plessis ‘Voorgestelde hersiening van voorkeureise by insolvensie’ 1985 De Jure 161.

\textsuperscript{234} For a full analysis of the policy grounds for and against such a suggestion, see Boraine and van Wyk ‘Reconsidering the plight of the five foolish maidens: Should the unsecured creditor stake a claim in real security?’ Tydskrif vir Hedendaagse Romeins-Hollandse Reg 2011 347-371.
When an asset of a sequestrated or liquidated debtor is realized, the costs of the maintenance and realisation of that asset is paid out of the proceeds of that asset as a first priority.\(^{235}\) If that asset serves as security for secured creditors’ claims, the proceeds are then paid out to those secured creditors’ in the order of the ranking of their preference (ie a first bondholder will be paid in full before a second bondholder is paid). Should a situation arise where the proceeds from the sale of the asset are sufficient to cover the realisation costs as well as settle all claims secured by that asset, the balance remaining is termed the ‘free residue’.\(^{236}\) If on the other hand all secured claims are not paid or are only settled in part, such secured creditors will have to claim the shortfall as concurrent creditors of the sequestrated estate and hope that free residue is achieved on other assets.\(^{237}\)

The free residue is first applied to pay certain specified priority creditors. The scheme of priority in terms of which the free residue is to be applied per the Insolvency Act may be summarized as follows:

*Firstly,* certain funeral and death-bed expenses;\(^{238}\)

*Second,* the costs of the sequestration or liquidation of the estate in question, with the exception of the costs of realisation of assets;\(^{239}\)

*Third,* certain costs of execution, such as the taxed fees of the sheriff, incurred for legal proceedings before sequestration or liquidation;\(^{240}\)

\(^{235}\) Section 89 of the Insolvency Act.

\(^{236}\) Defined in Section 2 sv Insolvency Act: ‘in relation to an insolvent estate, means that portion of the estate which is not subject to any right of preference by reason of any special mortgage, legal hypothee, pledge or right of retention.’

\(^{237}\) Refer to sections 89, 95 and 103(2) of the Insolvency Act.

\(^{238}\) Section 96 of the Insolvency Act.

\(^{239}\) Section 97 of the Insolvency Act.

\(^{240}\) Section 98 of the Insolvency Act.
Fourth, unpaid salaries or wages or related claims of former employees of the insolvent, for a period not exceeding three months, as well as any severance or retrenchment pay due to the employee; \(^{241}\)

Fifth, certain unpaid statutory obligations of an insolvent, including amounts due in respect of workmen’s compensation, sales tax, value-added tax and unemployment insurance contributions, which claims shall rank \textit{pari passu} and abate in equal proportion, if necessary; \(^{242}\)

Sixth, any income tax due by the insolvent to the South African Revenue Service; \(^{243}\)

Seventh, claims proved against the estate which were secured by a general mortgage bond, in their order of preference; \(^{244}\)

Eighth, non-preference claims, that is, concurrent creditors who are repaid \textit{pari passu}, that is, in proportion to the amount of each such claim; if all such claims have been paid in full, then interest on such claims from the date of sequestration to the date of payment may be paid on a \textit{pari passu} basis. \(^{245}\)

It is trite that in South African insolvency law a secured creditor is repaid first from the proceeds of security on which that secured creditor relies, but that such a security is also subject to the costs of realizing it. However, the security may also be subject to a number of other charges in favour of unsecured creditors, which have the effect of ‘carving out’ the secured creditor’s interest. Examples of such charges, which are usually mandated by legislation, will be discussed below.

\(^{241}\) Section 98A of the Insolvency Act.

\(^{242}\) Section 99 of the Insolvency Act.

\(^{243}\) Section 101 of the Insolvency Act.

\(^{244}\) Section 102 of the Insolvency Act.

\(^{245}\) Section 103 of the Insolvency Act.
7. Statutory provisions that limit or ‘carve out’ real security

A number of examples of instances where statutory provisions have the effect of ‘carving out’ a secured creditor’s claim and preferring certain unsecured creditors over secured creditors (as well as over other unsecured creditors in general) will be discussed below.

Numerous statutory provisions exist that confer a preference over certain unsecured creditors *vis-à-vis* all other unsecured creditors, but for the purposes of the current discussion the scope will be limited to instances where preference is already conferred on specified unsecured creditors in favour of secured creditors.\(^{246}\)

7.1 Municipal debt

Section 118(1) of the Local Government: Municipal Systems Act\(^ {247}\) provides as follows:

‘A registrar of deeds may not register the transfer of property except on production to that registrar of deeds of a prescribed certificate –

(a) Issued by the municipality or municipalities in which that property is situated; and

(b) Which certifies that all amounts that became due in connection with the property for municipal service fees, surcharges on fees, property rates and other municipal taxes, levies and duties during the two years preceding the date of application for the certificate have been fully paid.’

Such a provision is referred to as an ‘embargo’ or ‘veto’ provision. The first judgment to deal with a similar provision\(^{248}\) in our law occurred over a century ago – Innes CJ stated as follows in the case of *Cohen’s Trustees*.\(^{249}\)

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\(^{246}\) Instances where such unsecured creditors become what is generally termed a ‘preferent unsecured creditor’, that is, in preference to unsecured creditors in general, are listed in sections 96, 98, 99 and 101 of the Insolvency Act.

‘Now reading that section in connection with the other provisions of the statute, the intention seems to have been to give the local authority a right to veto the transfer of property until its claims in respect of rates should be satisfied. The result, of course, was to create, in effect, a very real and extensive preference over the proceeds of rateable property realized in insolvency; and to compel payment of the burden thus imposed before a sale of property could be carried through even in cases where insolvency had not supervened. The hold over the property thus given to the local authority is entirely the creation of statute; its object was to ensure payment of the liabilities due by ratepayers as such, and one would therefore think it was intended to continue until all liabilities arising out of rates had been discharged; in other words, that the account of the municipality against the property should be closed when transfer passed, and that transfer should not pass until it was closed.’

Similar provisions were to follow in Transvaal legislation\(^{250}\) until the promulgation of the Municipal Systems Act, which introduced the above-mentioned s 118(1), which has a time limit of two years prior to transfer. The embargo section survived a constitutional challenge,\(^ {251}\) but it was later confirmed that this embargo provision is solely limited to municipal debts incurred two years prior to the application for a municipal clearance certificate, and that the provision does not allow municipalities to withhold clearance certificates in respect of debt incurred prior to this two-year period.\(^ {252}\)

While the embargo provision gives a municipality a right to veto the transfer of a property until relevant debt is settled, they do not have the effect of rendering the municipality’s claim preferent to existing mortgages in the case of a sale of execution.\(^ {253}\) In other words, the nature of such a provision is that it gives the right to

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\(^{248}\) The provision in question being section 26 of the Local Authorities Rating Ordinance of 1903 (Transvaal), which contained an embargo provision that was unfettered by a time limit.

\(^{249}\) Johannesburg Municipality v Cohen’s Trustees 1909 TS 811, at 817.

\(^{250}\) Section 47 of the Local Government Ordinance 11 of 1926, followed by Section 50(1) of the Local Government Ordinance 17 of 1939 (both of which had time limits of three years prior to transfer).

\(^{251}\) Mkontwana op cit n 35.

\(^{252}\) Per Nugent JA in City of Cape Town v Real People Housing Ltd 2010 (5) SA 196 (SCA).

\(^{253}\) Rabie NO v Rand Townships Registrar 1926 TPD 286 (‘Rabie’); see also Nel NO v Body Corporate of the Seaways Building and Another 1996 (1) SA 131 (A) at 134B-135C; Firstrand Bank Ltd v Body Corporate of Geovy Villa 2004 (3) SA 362 (SCA) at 369F-370E.
resist any transfer unless the claim is paid, but it does not provide the right to have the property which is subject to the claim sold and be paid first out of the proceeds, nor does it provide the right, if the property is sold in execution by another creditor, to be paid first out of the proceeds.\textsuperscript{254} In response to judicial findings to this extent, the Transvaal legislature introduced a provision which read as follows:

\begin{quote}
\textquote{All such charges and sums mentioned in paragraphs (a) and (b) of subsection (1) shall be a charge upon the premises or interest in land in respect of which they are owing and shall be preferent to any mortgage bond passed over such property subsequent to the coming into operation of this Ordinance.}\textsuperscript{255}
\end{quote}

The above ‘charge’ was described as amounting to a tacit statutory hypothec,\textsuperscript{256} which effectively secures the municipal debt in preference to any other mortgage bond over the property in question. The current provision creating such a security in favour of the municipality is s 118(3) of the Municipal Systems Act, which reads as follows:

\begin{quote}
\textquote{An amount due for municipal service fees, surcharges on fees, property rates and other municipal taxes, levies and duties is a charge upon the property in connection with which the amount is owing and enjoys preference over any mortgage bond registered against the property.}
\end{quote}

There is no time limit in the wording of the above provision – the unlimited nature of this preference in favour of a municipality provided by s 118(3) has been confirmed by the Supreme Court of Appeal.\textsuperscript{257} However, the preference is only unlimited outside of insolvency due to the operation of s 118(2) of the Municipal Systems Act, which states:

\begin{quote}
\textquote{BOE Bank Ltd v City of Tshwane Metropolitan Municipality [2005] ZASCA 21.}
\end{quote}

\textsuperscript{254} \textit{Rabie} case at 292.

\textsuperscript{255} Section 50(2) of the Local Government Ordinance 17 of 1939.

\textsuperscript{256} See \textit{Stadsraad, Pretoria v Letabakop Farming Operations (Pty) Ltd} 1981 (4) SA 911 (T) at 918-C-G; \textit{Firststrand Bank Ltd v Body Corporate of Geovy Villa} n 143 supra at 368J-369A).

\textsuperscript{257} \textit{BOE Bank Ltd v City of Tshwane Metropolitan Municipality} [2005] ZASCA 21.
In the case of the transfer of immovable property by a trustee of an insolvent estate, the provisions of this section are subject to section 89 of the Insolvency Act, 1936 (Act No. 24 of 1936).  

Section 89 of the Insolvency Act provides as follows:

(1) The cost of maintaining, conserving and realizing any property shall be paid out of the proceeds of that property, if sufficient and if insufficient and that property is subject to a special mortgage, landlord’s legal hypothec, pledge, or right of retention the deficiency shall be paid by those creditors, pro rata, who have proved their claims and who would have been entitled, in priority to other persons, to payment of their claims out of those proceeds if they had been sufficient to cover the said cost and those claims. The trustee’s remuneration in respect of any such property and a proportionate share of the costs incurred by the trustee in giving security for his proper administration of the estate, calculated on the proceeds of the sale of the property, a proportionate share of the Master’s fees, and if the property is immovable, any tax as defined in subsection (5) which is or will become due thereon in respect of any period not exceeding two years which may be due on the said tax in respect of any such period, shall form part of the costs of realisation.

(2) If a secured creditor (other than a secured creditor upon whose petition the estate in question was sequestrated) states in his affidavit submitted in support of his claim against the estate that he relies for the satisfaction of his claim solely on the proceeds of the property which constitutes his security, he shall not be liable for any costs of sequestration other than the costs specified

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258 Heher JA in The City of Johannesburg v Kaplan NO and Another [2006] ZASCA 39 (‘Kaplan’) at para 18 explained that s 118(2) has its genesis in a proviso to an earlier embargo provision, which stated ‘provided that in the case of transfer of immovable property the provisions of this section shall be read subject to the provisions of section eighty-nine of the Insolvency Act, No. 24 of 1936, and the latter provisions shall apply.’ According to the learned judge, it would appear that the drafter of s 118 chose to treat the proviso as a substantive subsection but repeated its application to the whole of the section, where it would have been more logical to insert it after the security provision in subsection 118(3).
in subsection (1), and other than costs for which he may be liable under paragraph (a) or (b) of the proviso to section one hundred and six.\(^{259}\)

(3) Any interest due on a secured claim in respect of any period not exceeding two years immediately preceding the date of sequestration shall be likewise secured as if it were part of the capital sum.

(4) Notwithstanding the provisions of any law which prohibits the transfer of any immovable property unless any tax as defined in subsection (5) due thereon has been paid, that law shall not debar the trustee of an insolvent estate from transferring any immovable property in that estate for the purpose of liquidating the estate, if he has paid the tax which may have been due on that property in respect of the periods mentioned in subsection (1) and no preference shall be accorded to any claim for such a tax in respect of any other period.

(5) For the purposes of subsections (1) and (4) ‘tax’ in relation to immovable property means any amount payable periodically in respect of that property to the State or for the benefit of a provincial administration or to a body established by or under the authority of any law in discharge of a liability to make such periodical payments, if that liability is an incident of the ownership of that property.

Subsection 89(4) of the 1936 Insolvency Act featured a significant addition from its equivalent provision under the earlier Insolvency Act,\(^ {260}\) that addition being the phrase ‘\textit{and no preference shall be accorded to any claim for such a tax in respect of any other period.}’

It was confirmed in Kaplan\(^ {261}\) that the reason for the addition was clear: due to a growing practice of creating statutory quasi-liens and statutory charges or preferences – which had no limit placed on its duration outside of insolvency – section 89(4)’s purpose was to provide certainty to creditors and trustees of the rights

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\(^{259}\) Section 106 deals with contributions by creditors towards the costs of sequestration where the free residue is insufficient to meet those expenses.

\(^{260}\) Section 88(4) of the Insolvency Act 32 of 1916.

\(^{261}\) Op cit n 257, at paras 20-21.
and obligations attaching to the realisation of immovable property, and therefore operates to limit the duration of preferences which arose from statutory quasi-liens and charges.\textsuperscript{262}

Once a debtor has been sequestrated or liquidated, as far as municipal debts owed by that debtor is concerned, the preference in favour of the municipality operate as follows:

1. The municipality has the benefit of the embargo clause which allows it to prevent transfer of immovable property by refusing a clearance certificate until all municipal debt owed to it by the debtor for a period of two years immediately preceding the date of application for the clearance certificate has been paid.

2. To the extent that there is additional remaining municipal debt, the municipality is then provided with a preference through the security clause, but to the extent that any portion of that municipal debt are ‘taxes’ within the meaning of s 89(5), the preference in respect of such debt is limited to a period of two years prior to the date of sequestration or liquidation of the debtor. To the extent that any portion of that municipal debt does not fall within the meaning of ‘taxes’, s 89(4) does not operate to limit the preference in favour of the municipality.\textsuperscript{263}

It has been confirmed by the Supreme Court of Appeal that, outside of insolvency, the preference provided by s 118(3) has the effect of providing municipalities with a lien ‘having the effect of a tacit statutory hypothec…and no time limit is placed on its duration outside of insolvency…so that a municipality

\textsuperscript{262} In Kaplan, Heher JA referred to examples listed in a South Rhodesian case, Commissioner of Taxes v Master and Trustee in Insolvent Estate Collias 1930 SR 12 at 16, as well as Mars (Hockly ed) The Law of Insolvency 3rd edition (1936) at 352-3.

\textsuperscript{263} See Eastern Substructure of Greater Johannesburg Transitional Council v Venter NO 2001 (1) SA 360 (SCA) at 369B-D.
enjoys preference over a registered mortgage bond on the proceeds of the property.\textsuperscript{264}

Section 89 of the Insolvency Act does not apply to business rescue proceedings. Therefore, once business rescue proceedings have commenced, there is no time limit placed on the preference in favour of municipalities.

\textbf{7.2 Body corporate levies}

The Sectional Titles Act\textsuperscript{265} provides that the Registrar of Deeds shall not register a transfer of a unit unless there is produced to him a conveyancer’s certificate confirming that, as at date of registration, the body corporate of the sectional scheme in question has certified that all moneys due to the body corporate by the seller of the unit in question have been paid, or that adequate provision to the satisfaction of the body corporate for payment thereof has been made.\textsuperscript{266} This effectively provides a body corporate with an embargo provision similar to section 118(1) discussed above. The effect of such an embargo provision in insolvency proceedings is that a body corporate enjoys an effective preference\textsuperscript{267} in respect of unpaid pre-liquidation levies – proceeds from the sale of an encumbered asset will only be able to flow to the secured creditor concerned once the body corporate has been settled, which means that a body corporate effectively ranks in priority before secured creditors.\textsuperscript{268}

This embargo provision in favour of bodies corporate was inserted by the first Sectional Titles Amendment Act,\textsuperscript{269} apparently after representations made by the—

\textsuperscript{264} Per Ponnan JA in \textit{City of Tshwane Metropolitan Municipality v Mathabathe and Another} [2013] ZASCA 60 at para 10.

\textsuperscript{265} Act 95 of 1986.

\textsuperscript{266} Section 15B(3)(a) of the Sectional Titles Act, Act 95 of 1986.

\textsuperscript{267} As explained in the \textit{Rabie} case, this is not a preference in the ordinary sense of being a ‘claim ranking in priority’ over a mortgage bond.

\textsuperscript{268} See \textit{Nel NO v Body Corporate of the Seaways Building and Another} [1995] ZASCA 83 for a general discussion of the embargo provision in favour of bodies corporate of sectional title schemes.

\textsuperscript{269} Act 63 of 1991.
Institute of Estate Agents of South Africa for such protection on the basis that bodies corporate were suffering losses in the event of insolvency. It was the opinion of the South African Law Commission that it was ‘quite remarkable that the special protection was conferred at all’.\(^{270}\)

It should be noted that the embargo provision in favour of a body corporate is unfettered by a time limit.\(^{271}\) Van der Merwe\(^{272}\) argued that the embargo provision in favour of a body corporate should apply for a period of six months’ arrear levies only, and that limiting it to such a period balances the competing interests of, on the one hand, needing to provide a mechanism to bodies corporate to enforce collection of unpaid levies, and, on the other hand, protect the security interests of mortgage lenders.\(^{273}\) However, the Commission did not even agree with this shortened period and argued for the complete abolition of the embargo provision in favour of bodies corporate,\(^{274}\) which recommendation was not acted upon and the special protection persists.

Under business rescue proceedings, where a sectional title unit is one of the assets of the company under supervision, there will therefore be an unlimited effective preference in favour of the body corporate of that sectional scheme for any and all arrear levies payable to it.

### 7.3 Home owners’ association levies

Home owners’ associations may come into being by virtue of the discretion of a competent authority to impose a condition requiring the compulsory establishment of

\(^{270}\) Op cit n 76 at para 7.11.

\(^{271}\) However, cognizance must be had of the possibility of extinctive prescription in terms of the Prescription Act, Act 68 of 1969.

\(^{272}\) 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 *Tydskrif vir Hedendaags Romeins-Hollandse Reg* 367.

\(^{273}\) Ibid at 386-387.

\(^{274}\) Op cit n 76 at 7.12.
such a home owners’ association before approval is granted for the subdivision of land. An example of this is section 29 of the Land Use Planning Ordinance275 (‘LUPO’), which indicates that such a home owners’ association shall be a body corporate with a constitution which has its object the control over and the maintenance of buildings, services and amenities arising from the subdivision concerned, and shall have as its members the owners of land units arising from such subdivision, who shall be jointly liable for expenditure incurred in connection with the association.276 In terms of the conditions of establishment of a township register being opened under the so-called Transvaal Ordinance,277 a condition may be imposed to create a home owners’ association as an incorporated non-profit company.278

The joint liability of members of a home owners’ association for the expenditure of that association are represented in the form of proportional levies paid by each member. These levies bear a very strong resemblance to levies payable to a body corporate of a sectional scheme. To provide a tool to assist such home owners’ associations with the collection of levies, it has become common practice to register conditions of title in the title deeds of members of home owners’ associations which effectively provide for the following:

1. That compulsory membership of the home owners’ association in question is binding on successors-in-title of the land unit in question;
2. That transfer of the land unit in question may only be registered in the Registry of Deeds upon submission of a clearance certificate from the home owners’ association consenting to that transfer; and

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275 Ordinance 15 of 1985, which is applicable to the Western Cape, Eastern Cape and Northern Cape. Compulsory establishment of homeowners’ associations could also be a condition of approval of subdivision under the earlier Townships Ordinance, 1934 (Ordinance 33 of 1934).

276 Ibid, s 29(2).

277 Town-Planning and Townships Ordinance No. 15 of 1986, which is applicable in Gauteng, Mpumalanga, North West and Limpopo Provinces.

278 Section 10 of the 2008 Companies Act; previously these were so-called section 21 not-for-profit companies under the 1973 Companies Act.
3. That such consent from the home owners’ association may not be unreasonably withheld, but may be done so if the member in question has not paid in full any and all amounts due by her to the home owners’ association in respect of that land unit.

The ability of a home owners’ association to prevent transfer until the debt associated with a land unit has been paid to it is an embargo provision akin to s 118(1) of the Municipal Systems Act\textsuperscript{279} and s 15B(3)(a) of the Sectional Titles Act.\textsuperscript{280} This similarity has been confirmed by the Supreme Court of Appeal in two very recent judgments,\textsuperscript{281} and it has been confirmed that the rights in favour of home owners’ associations by virtue of such title deed conditions constitute limited real rights that are capable of registration against the title deed. It was argued in the \textit{Willow Waters} case – in comparing these rights in favour of home owners’ associations to statutory embargo provisions – that embargoes ‘serve a vital and legitimate purpose as effective security for debt recovery in respect of municipal service fees and contributions to bodies corporate for water, electricity, rates and taxes etc. Thus, they ensure the continued supply of such services and the economic viability and sustainability of municipalities and bodies corporate in the interest of all inhabitants in the country.’\textsuperscript{282}

Of course, such limited real rights affording an effective preference to home owners’ associations will only be enforceable in such cases where such an embargo provision has been registered against the title deed.

It is worth noting that any qualification of the embargo in favour of home owners’ associations will be dependent on the wording of the title condition in question, but it appears highly unlikely that home owners’ associations will limit the

\textsuperscript{279} 7.1 above.

\textsuperscript{280} 7.2 above.

\textsuperscript{281} \textit{Willow Waters Homeowners Association (Pty) Ltd v Koka and Others (two Amici Curiae intervening)} [2014] ZASCA 220 (‘Willow Waters’) and \textit{Cowin NO and Others v Kyalami Estate Homeowners Association and Others (two Amici Curiae intervening)} [2014] ZASCA 221 (‘Cowin’).

\textsuperscript{282} \textit{Willow Waters}, para 25.
applicability thereof to a specific time period prior to the application for consent to the transfer.

7.4 Observations

It is clear that there is a long precedent in South African law to make statutory provision for the effective preference of certain specified unsecured creditors above secured creditors. Outside of insolvency these effective preferences in respect of any unpaid municipal rates and charges, body corporate levies and home owners’ association levies are unfettered by a time limit; and, as it stands, in insolvency only the effective preference of municipal debt will be subject to any qualification. 283

It is clear that these provisions involve the impairment of the right of a secured creditor in favour of a specified unsecured creditor on policy grounds, usually the public interest. It should be noted that, in the case of municipal debt and body corporate levies, these preferences are specifically imposed by unambiguous and clear legislative intent. In the case of home owners’ associations, the embargo provision forms part of the conditions of title of an immovable property and if the property in question is taken as security by a creditor, then it must be argued that the secured creditor in question is aware of the embargo provision and implicitly consents to have her right to proceeds curtailed.

It is submitted that, in the context of business rescue, when considering granting a preference to post-commencement funders in priority to existing pre-commencement secured creditors, such a provision should be defensible on policy grounds, and should likewise either be imposed by clear and unambiguous legislative intent (which should survive the scrutiny of constitutionality), or alternatively involve substantial consent on the part of a secured creditor to the deprivation.

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283 See 7.1 above.
8. Conclusion

It is submitted, with respect, that the ranking of priorities of creditors’ claims during business rescue proceedings as set out by Kgomo J in both Merchant West and Redpath Mining is incorrect.

Wessels J said the following in Casserley v Stubbs:284

‘It is a well-known canon of construction that we cannot infer that a statute intends to alter the common law. The statute must either explicitly say that it is the intention of the legislature to alter the common law, or the inference from the Ordinance must be such that we can come to no other conclusion that the legislature did have such an intention.’

Shortly before this Lord Mersey had shared such sentiments in the English Court of Appeal:285

‘It is a strong thing to read into an Act of Parliament words which are not there, and in the absence of clear necessity it is a wrong thing to do.’

On no occasion does the wording of section 135 refer to pre-commencement secured creditors, and if it was the intention of the legislature to alter the law as far as it relates to the distribution rules in South African insolvency law, it must explicitly state so or, as Wessels J said, ‘the inference…must be such that we can come to no other conclusion that the legislature did have such an intention.’

If we utilise the approach to statutory interpretation set out by Wallis JA in Endumeni,286 upon a clear reading of the ordinary language of both sections 134 and 135 it is possible to construct an interpretation of these two provisions that are not in conflict with one another, and which in fact is supported by the context provided by both the background and stated purposes of business rescue in South Africa, as well

284 1916 T.P.D. 310 at 312.

285 Thompson v Goold (1910) A.C. 409 at p 420.

286 See n 43.
as being consistent with the materials known to its drafters, being the best practice encountered in international jurisdictions.

The structure of the two provisions in question, sections 134 and 135, resemble to a certain extent the structure of § 506 and § 507 in Chapter 5 of the US Bankruptcy Code. § 506 confirms the rights of secured creditors, while § 507 sets out the priority of unsecured claims.

It is submitted that the correct ranking of the priority of creditors’ claims during business rescue proceedings should be as follows:

1. The practitioner’s remuneration and expenses;
2. Secured pre-commencement claims;
3. Deemed employee post-commencement finance, *pari passu*;
4. Secured post-commencement finance;
5. Employee (unsecured) claims for remuneration that arose prior to business rescue proceedings commencing, *pari passu*;
6. Unsecured post-commencement finance in the order in which they were incurred;
7. Employee (unsecured) claims for remuneration that arose prior to business rescue proceedings commencing, *pari passu*;
8. Other unsecured pre-commencement claims, *pari passu*.

The above ranking compares favourably with the recommendations of international bodies such as UNCITRAL and the World Bank. A priority is established for post-commencement finance that allows repayment prior to ordinary pre-commencement unsecured creditors, and post-commencement finance providers are able to obtain security from a company in business rescue.

It is undoubted that post-commencement finance is crucial for successful business rescues, and that the legislature foresaw that some form of incentive had to be offered to induce the a funder to provide such finance. This inducement was provided in the form of the preference provided to post-commencement funders over all pre-commencement unsecured creditors. However, it is clear that the legislature
did not go as far as providing an equivalent provision to §364(d) of the US Chapter 11 proceedings, which allows for so-called ‘priming liens’.

As discussed, there is a long precedent of statutory provisions that allow for the ‘carving out’ of secured creditor’s interests in favour of unsecured creditors. If it really is the intention of the legislature to allow for pre-commencement secured creditors to have their real security in business rescue proceedings carved out in favour of post-commencement financiers, then such intention must be clearly and unambiguously expressed in the form of an amendment to Chapter 6. Of course, any such provision would need to pass constitutional muster, as the argument could be made that it amounts to arbitrary deprivation of property.

In the absence of statutory intervention – which appears unlikely – it will fall to the courts to ensure that the considerable uncertainty that has been created in the wake of the Merchant West and Redpath Mining decisions is dispelled as quickly as possible.
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