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Mary Jo Newborn Wiggins

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I. INTRODUCTION

The nation of South Africa has undergone one of the most stunning political transformations in history. With the dismantling of apartheid and the adoption of a new constitution by a multi-racial parliament, South Africa is now a country that aspires to democracy, multi-racialism, and cultural pluralism in its national political structure.[1]

This political transformation is having far-reaching economic effects. Record levels of capital flood the stock markets.[2] The privatization of state assets proceeds, albeit slowly.[3] The price controls that heretofore protected sanction-weary industries are gradually being lifted.[4] Foreign investment has risen steadily.[5] As one observer astutely notes, South Africa "offers the

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* Professor of Law, University of San Diego, B.A., Smith College, 1984, J.D., University of Michigan, 1987. Thanks to Angela Allegra and Benjamin Morton for their research assistance.

1. *Parliament Adopts Landmark Constitution*, All Afr. Press Service, May 14, 1996, *available in* LEXIS, World Library, Curnws File. *But see* Sammy Adelman, *Some Prospects and Problems for a Post-Apartheid Constitution for South Africa*, 1989 THIRD WORLD LEGAL STUD. 119, 120 (arguing that constitutional mechanisms may "prevent the emergence of a pluralistic participatory society").

2. Simon Segal, *Corporate South Africa Sees Growth*, MAIL & GUARDIAN (Johannesburg), May 10, 1996, *available in* LEXIS, World Library, Curnws File.

3. Mungo Soggot, *South Africa Puts Privatization Back on Track*, MAIL & GUARDIAN (Johannesburg), May 10, 1996, *available in* LEXIS, World Library, Curnws File.

4. Mungo Soggot, *New Hope For The Fuel Industry*, MAIL & GUARDIAN (Johannesburg), May 17, 1996, *available in* LEXIS, World Library, Curnws File.

5. Gary S. Eisenberg, *The Policy and Law of Foreign Direct Investment in the New South Africa*, 1994 J. WORLD TRADE 5, 9; S. Prakash Sethi, *American Corporations and the Economic Future of South Africa*, 1995 BUS. & SOC'Y REV. 10, 17; Barbara J. Morrow, *Discarding Investment Myths: A Global Investor's Perspective*, N.Y.L.J., Nov. 21, 1994, at S5.

sophistication of an established market and the growth potential of an emerging market."[6] Its inclusion in this symposium issue is therefore, quite appropriate.

These political and economic changes are prompting a re-examination of the law that governs corporate structures, finance and governance.[7] Although not an immediate priority, another area of law that will require rethinking is South African insolvency law. This article suggests some features of that law that are now ripe for reexamination.

II. THE TENDENCY TOWARD CREDITOR CONTROL

South African insolvency law, with origins in both Dutch and English law[8], is creditor-oriented.[9] Two examples demonstrate this point. First, there exists the requirement that a sequestration[10] may not occur unless it is "to the advantage of creditors."[11] Although the debtor's aspirations are not entirely irrelevant, it is clear that under South African law, the court must give priority to the aims of creditors. This is unlike United States law, where creditor collection and debtor relief are said to be co-equal policy goals.[12] Although at least one commentator has criticized the "advantage to creditors" approach,[13] it remains integral.

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6. Theodore C. Sorenson, *Benign Laws Should Lure Investment*, N.Y.L.J., Nov. 21, 1994, at S1.

7. Interview with Ronald Roberts, Esq., Partner, Moseneke & Partners, South Africa, in New York, N.Y. (April 22, 1996).

8. *See* Tienie Cronje, *Developments in South African Insolvency Law*, 9 INSOLVENCY L. & PRAC. 34 (1993).

9. *See* G Friedman, *Foreward* to WALTER HERBERT MARS, THE LAW OF INSOLVENCY IN SOUTH AFRICA at iii (David Frobisher Waters & Richard Dennis Jooste eds., 7th ed. 1980) (suggesting the unchanging concept of *concursus creditorum* as a basic concept of South African insolvency law); *See also* Richard A. Gitlin & Timothy B. DeSieno, *Bankruptcy Laws of South Africa*, 17 N.Y.L. SCH. J. INT'L & COMP. L. 283 (1997).

10. As an aid to understanding South African insolvency law, American insolvency lawyers should substitute the word "bankruptcy" for the term "sequestration" throughout this article.

11. *See* WALTER HERBERT MARS, THE LAW OF INSOLVENCY IN SOUTH AFRICA §§ 3.32, 5.34 (David Waters & Richard Jooste eds., 7th ed. 1980). *See also* DAVID SHRAND, THE LAW AND PRACTICE OF INSOLVENCY, WINDING-UP OF COMPANIES AND JUDICIAL MANAGEMENT 2 (3rd ed. 1977).

12. *See* PETER A. ALCES & MARGARET HOWARD, CASES AND MATERIALS ON BANKRUPTCY 11 (1995); DAVID EPSTEIN ET AL., BANKRUPTCY 6 (1993). *See also* Local Loan Co. v. Hunt, 292 U.S. 234 (1934).

13. Cronje, *supra* note 8, at 35 (arguing that requirement that sequestration be to

The concept of "civil imprisonment"[14] is another creditor-focused remedy that continues as a feature of South African law.[15] For example, Section 74S of the Magistrates' Courts Act provides that an insolvent debtor who incurs debt after the sequestration can be imprisoned for a period not exceeding 90 days.[16] No doubt this punitive aspect of the system can be traced, at least in part, to its English origins.[17]

The growing dynamism of the economy may force insolvency professionals to rethink the commitment to a creditor-focused, punitive system. As privatization continues and sanctions lifted, the markets will become increasingly competitive.[18] This will probably lead to a sharp surge in bankruptcies and increased public attention to insolvency issues.[19] This should, in turn, create incentives for creditors to internalize more of the risk of extending credit. Financial institutions that extend credit without adequate and reasonable investigation should not expect that an attentive public will continue to indulge them with a pro-creditor statute. Concurrent with this trend, a more dynamic economy should encourage risk-taking, with both human and financial capital. Inevitably, some risks, even prudent ones, will fail. Hence, the system must incorporate a stronger commitment to debtor relief. This will have the beneficial effect of releasing human and financial capital for new ventures. The need for a fresh start policy may be especially compelling for South Africa because the country at present does not have a meaningful "safety net."[20]

These economic changes, together with constitutional advancements, also provide an opportunity to revisit the concept of civil imprisonment. Debtors' prisons encourage creditors to externalize risk. An increasingly competitive economy cannot sustain itself with a significant number of citizens serving prison time for nonpayment of debts. Debtor

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advantage of creditors impairs debtor's fresh start).

14. *See* MARS, §15.11, at 295.

15. § 20(1)(d) of Insolvency Act 24 of 1936, BSRSA (S. Afr.) (providing that the effect of a sequestration order is to allow a debtor to apply to the court for his release if he has been imprisoned).

16. § 74S of Magistrates' Court Act of 1976, BSRSA (S. Afr.).

17. Statute of Bankrupts, 1570, 13 Eliz., ch. 7 (Eng.). *See also* Louis Edward Levinthal, *The Early History of English Bankruptcy*, 67 U. PA. L. REV. 1, 16-18 (1919); Gitlin & DeSieno, *supra* note 9.

18. *See* Sethi, *supra* note 5, at 10.

19. This trend has already begun. *See South Africa Mandela Calls For A Mixed Economy*, BBC World Broadcasts, Nov. 25, 1991, *available in* LEXIS, Aust Library, Bbcswb File.

20. *See* Morrow, *supra* note 5, at S10.

imprisonment also discourages the risk-taking necessary for optimal growth rates in a privatized economy. Lastly, but no less important, debtor imprisonment stands in direct contrast to the values of liberty and privacy which the new Constitution enshrines.[21]

III. THE LIQUIDATION BIAS AND EXTERNAL CONTROL IN REORGANIZATION

In South Africa, all companies that seek relief from indebtedness under the insolvency law must start with liquidation.[22] Reorganization, also known as "judicial management"[23], is an option only in cases where: 1) a "winding up"[24] has been filed, and 2) there exists a reasonable possibility for the entity to succeed.[25] This procedure effectively restrains the choices for structuring relief from indebtedness and carries with it some efficiency gains.

If relief from indebtedness takes the form of judicial management, responsibility for restructuring goes to an outsider, called a "judicial manager."[26] Current management is divested of formal control over the restructuring. The judicial manager must manage the company in an economic and productive manner.[27] The judicial manager and the creditors effectively control the reorganization.

Reform of these two basis structures (i.e., mandatory liquidation filings and outsider control in judicial management) may be warranted. The increased dynamism of the South African economy will bring with it diversity in corporate structures and constituencies. The country should expect to see a rise in the number of small businesses and in

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21. S. AFR. CONST. ch 1, §12, 13 & 14 (1996) (providing for " freedom and security of the person," "slavery, servitude and forced labor," and "privacy."). *See also A Constitutional Struggle,* LAWYER INTERNATIONAL, June 1995, at 6, *available in* LEXIS, World Library, Curnws File. For a discussion and analysis of these provisions as they appeared in the interim Constitution, *see* Anton J. Steenkamp, *The South Africa Constitution of 1993 and the Bill of Rights: A n Evaluation in Light of International Human Rights Norms*, 17 HUM. RTS. Q. 101, 109-113 (1995).

22. *See* Gitlin & DeSieno, *supra* note 9.

23. *See* Shrand, *supra* note 11, at 325.

24. The terms "winding up" and "liquidation" can be used interchangeably.

25. § 427(3) of Companies Act of 1973, as amended, BSRSA (providing that the order for judicial management must be preceded by an application for wind-up). *See also* Shrand, *supra* note 11, at 326.

26. *See* Shrand, *supra* note 11, at 332.

27. § 433(b) of Companies Act of 1973, as amended, BSRSA.

entrepreneurship generally. There may also arise an increasing number and variety of creditors. For example, until recently, most executives who worked for corporations retired without pensions.[28] This is likely to change as newly privatized corporations revisit their commitment to the professional managerial class. These factors should necessitate more consideration for the specific *contexts* in which insolvency arises.

Increased specialization should accompany privatization. Management may become more self-conscious and more economically and psychologically invested in the businesses they run. There will likely be more resistance to the concept of outsider control. With these developments, there should be a reexamination of the traditional assumption that the largest efficiency gains come from outsider control. Reportedly, some creditors already complain about the inefficiencies generated from turning formal control over to a third party manager.[29]

IV. CONCLUSION

Close to a decade ago, policy makers within the nation engaged in extensive study of South African insolvency law.[30] Yet, the present economic and political circumstances indicate this might be the most optimal time to revisit the system. Change is inevitable and insolvency law should not stand still. Instead, insolvency professionals, in South Africa and throughout the world need to think creatively about how they can help the nation's insolvency law bridge the gap from the past to the future.

28. *See* Morrow, *supra* note 5, at S5.

29. *See* Gitlin & DeSieno, *supra* note 9.

30. *See* Cronje, *supra* note 8, at 34.