

# Some thoughts on state regulation of South African insolvency law\*

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## OPSOMMING

### Enkele gedagtes oor staatsregulering van die Suid Afrikaanse insolvensiereg

Die grondslag van konstitusionalisme is dat die mag van die staat omskryf en ingeperk moet word om die belange van die gemeenskap te beskerm en daarom moet die doel van enige staatsregulering in Suid-Afrika wees om die onderliggende waardes van die Grondwet te ondersteun en te beskerm. Die belang van 'n moderne insolvensieregstelsel as belangrike hoeksteen van volhoubare ekonomiese ontwikkeling is ook wyd erken en deur internasionale instellings soos die Wêreldbank gedokumenteer. Terwyl die fokus van die regshervormingsproses van die insolvensiereg dus moet wees om die belange van die gemeenskap te beskerm sal dit onrealisties wees om die breë internasionale konteks te ignoreer.

Die artikel bespreek die geskiedenis, rol en funksie van die Meester van die Hooggeregshof en lig sekere probleme ten opsigte van die Meester se toesighoudende funksie oor die insolvensiereg uit. Die aanbeveling word gemaak dat ten einde aan die internasionale standaarde te voldoen asook die vertroue van die plaaslike gemeenskap te herwin, is dit nodig om 'n onafhanklike reguleerder as deel van 'n reguleringsraamwerk in die Suid-Afrikaanse insolvensiereg in te stel. Na aanleiding van die grondwetlike aspekte van die reguleringsfunksie asook die internasionale maatstawwe wat geïdentifiseer word, word daar dus aanbeveel dat die Suid Afrikaanse regs- en beleidmakers terugkeer na die regshervormingsproses en opnuut die konsep van staatsregulering in die insolvensiereg oorweeg.

## 1 Introduction

The question may be asked how the concept of state regulation in general fits in with our perception of a modern insolvency law system. The key factors that influence a country's insolvency system on an economic, social and political level join forces to create the so-called "cornerstones" or "building blocks" identified as essential to an effective insolvency law system.<sup>1</sup> These cornerstones consist of the legal framework, which represents the various areas of law impacting on the system,<sup>2</sup> the institutional cornerstone, which is generally thought to be

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1 Johnson "Toward International Standards on Insolvency: The Catalytic Role of the World Bank" 2000 *Law in Transition* 71.

2 *Inter alia* insolvency law, corporate law, tax law and labour law.

the courts,<sup>3</sup> and the regulatory cornerstone, which consists of both the establishment and implementation of a regulatory body that has oversight and responsibility for implementing the regulatory procedures as well as the content of the regulations applicable to office holders responsible for the administration of insolvent estates. The success of the entire insolvency system rests on the proper functioning of all three cornerstones.<sup>4</sup>

With the recognition of the Constitution<sup>5</sup> as the supreme law of the land, the legal community in South Africa has had to adapt from the old concept of parliamentary sovereignty to a new model of constitutional democracy.<sup>6</sup> In *Holomisa v Argus Newspaper Ltd*<sup>7</sup> Cameron J summarised this principle very well: "The Constitution has changed the 'context' of all legal thought and decision-making in South Africa".<sup>8</sup> The foundation of constitutionalism is the principle that the power of the state is defined and circumscribed by law to protect the interests of society and thus the aim and purpose of any state regulation in South Africa should be to ensure compliance with the underlying values of the Constitution, which include the protection of societal interests.<sup>9</sup>

The significance of a modern insolvency system as a key foundation of sustainable economic development has widely been acknowledged and documented by international institutions such as the World Bank<sup>10</sup> and the United Nations Commission on International Trade Law

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- 3 With regard to the institutional framework of South African insolvency law, South Africa does not at present have specialised insolvency courts. The High Courts in general deal with insolvency matters, and play their part both in applying and developing the law through case law. During the late 1990s a high-level Commission of Inquiry, the Hoexter Commission, rejected proposals for specialised insolvency courts in South Africa. See the third and final report of the *Commission of Inquiry into the Rationalization of the Provincial and Local Divisions of the Supreme Court* vol 1 Book 2 Part 3 (1997) Report number RP 201/9.
  - 4 Uttamchandani "The Case for a Strong Regulatory Framework: The World Bank Principles in Asia" (2006) unpublished paper presented at the Forum on Asian Insolvency Reform V, China. On file with the author.
  - 5 Constitution of the Republic of South Africa, 1996.
  - 6 Hoexter "'Administrative Action' in the Courts" 2006 *Acta Juridica* 303.
  - 7 1996 6 BCLR 836 (W) 836J.
  - 8 Botha "Administrative justice and interpretation of statutes: a practical guide" in *The Right to Know* (ed Lange) (2004) 14.
  - 9 Burns *Administrative Law under the 1996 Constitution* (2003) 28.
  - 10 See World Bank *Principles for Effective Insolvency and Creditor Rights System* (2001) (also referred to as *Principles for Effective Insolvency and Creditor Rights System*) at [http://www.worldbank.org/ifa/lipg\\_eng.pdf](http://www.worldbank.org/ifa/lipg_eng.pdf) (accessed 2011-07-31); World Bank *Revised Principles for Effective Insolvency and Creditor Rights Systems* (2005) (also referred to as *Revised Principles for Effective Insolvency and Creditor Rights Systems*) at <http://siteresources.worldbank.org/GILD/Resources/FINAL-ICRPrinciples-March2009.pdf> (accessed 2011-07-31); the revised and updated version *Principles for effective insolvency and creditor/debtor regimes* (2011) (also referred to as *Principles for effective insolvency and creditor/debtor regimes*) at [http://siteresources.worldbank.org/INTGILD/Resources/ICRPrinciples\\_Jan2011.pdf](http://siteresources.worldbank.org/INTGILD/Resources/ICRPrinciples_Jan2011.pdf) (accessed 2011-07-31).

(UNCITRAL).<sup>11</sup> There is furthermore a general recognition that, in turn, those systems depend on the existence of strong and efficient regulatory frameworks.<sup>12</sup> While the primary focus of the reform process of insolvency law and institutions should thus be on how best to serve the needs and interests of society, it would be unrealistic to ignore the wider global context in which trade and commerce take place.

This article will not attempt to deal with the regulation of the insolvency profession *per se*, but will instead aim to emphasise the importance of a fresh approach to law reform in the field of state regulation of insolvency law, and subsequently certain recommendations will be made. The recommendations are not intended to be exhaustive, nor do they attempt to set out the entire groundwork for law reform in the field of insolvency law. The main objective is rather to propose and highlight certain vital design features with regard to state regulation which could complement any future policy design and law reform initiatives.

## 2 Overview of State Regulation from an International Perspective

In the aftermath of the Asian financial crisis in the late part of the previous century, the World Bank launched an initiative to improve the future stability of international financial systems.<sup>13</sup> This took the form of a project to identify certain principles and guidelines for sound insolvency systems and for the strengthening of related debtor-creditor rights in emerging markets.<sup>14</sup> In consensus with international partner organisations the *Principles and guidelines for effective insolvency and creditor rights system* transpired and were approved in 2001.<sup>15</sup> The publication has recently been thoroughly reviewed and updated and the title changed to *Principles for effective insolvency and creditor/debtor regimes*.<sup>16</sup> In the executive summary of the 2011 document the following significant statement is made:

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- 11 See UNCITRAL *Legislative Guide on Insolvency Law* (2005) at [http://www.uncitral.org/pdf/english/texts/insolven/05-80722\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf) (accessed 2011-07-31). See further Wessels *Cross-Border Insolvency Law – International Instruments and Commentary* (2007) for a collection of international and regional legal instruments relating to insolvency of companies, financial institutions, and consumers, as well as to corporate rescue law.
- 12 Pistor "The standardization of law and its effect on developing economies" *The American Journal of Comparative Law* 2002 97. See also Joyce "The Role of Insolvency Regulators in the Past and in the Future" (2003) 4 unpublished paper presented at the International Insolvency Conference, Singapore. On file with the author.
- 13 Wessels "Insolvency Law" 305 in *Elgar Encyclopedia of Comparative Law* (ed Smits)(2006).
- 14 Wessels 2.
- 15 *Supra* (n 10).
- 16 *Ibid.*

Strong institutions and regulations are crucial to an effective insolvency system. The institutional framework has three main elements: the institutions responsible for insolvency proceedings, the operational system through which cases and decisions are processed, and the requirements needed to preserve the integrity of those institutions – recognizing that the integrity of the insolvency system is the linchpin for its success. A number of fundamental principles influence the design and maintenance of the institutions and participants with authority over insolvency proceedings.<sup>17</sup>

In the context of this article it is important to take note of principle D7 of the *Principles for effective insolvency and creditor/debtor regimes* as it outlines the international standard and perspective on the role of the supervisory body in the regulation of insolvency law in general.<sup>18</sup> The suggested principles are specified as follows:

#### Role of Regulatory Supervisory Bodies

The bodies responsible for regulating or supervising insolvency representatives should:

- Be independent of individual representatives;
- Set standards that reflect the requirements of the legislation and public expectations of fairness, impartiality, transparency and accountability; and,
- Have appropriate powers and resources to enable them to discharge their functions, duties and responsibilities effectively.

In determining whether it is feasible to bring about a new regulatory regime in South African insolvency law, reference to other jurisdictions can be made. This may prove to be a useful benchmark in order to establish whether regulation in South African insolvency law has fallen out of step with developments in other jurisdictions. Due to the fact that South African insolvency legislation has been partly modelled on English law,<sup>19</sup> it seems sensible to refer to the regulatory methodology within the English bankruptcy systems in an attempt to establish whether the global norms identified as such could also provide domestic policy- and lawmakers with persuasive and digestible solutions and policy considerations.<sup>20</sup>

The United Kingdom (UK)<sup>21</sup> adopted an administrative system whereby the Insolvency Service is responsible for virtually all important

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17 *Principles for effective insolvency and creditor/debtor regimes* 5.

18 *Idem* 20-22.

19 South Africa has 'inherited' most of its insolvency legislation from England. See Burdette *Framework for Corporate Insolvency law reform in South Africa* (LLD thesis UP 2002) Part 2 77.

20 See Tabb "The History of the Bankruptcy Laws in the United States" 1995 *American Bankruptcy Institute LR* 5; Martin "Common- Law Bankruptcy Systems: Similarities and Differences" 2003 *American Bankruptcy Institute LR* 367.

21 The UK consists of three separate jurisdictions or law districts: (i) England and Wales; (ii) Scotland; and (iii) Northern Ireland. The term UK in this chapter is used generically to refer to the jurisdiction of England and Wales. From a formal perspective the main source of the English bankruptcy law is to be found in the Insolvency Act of 1986.

decisions and the establishment of detailed interpretations of statutory rules.<sup>22</sup> This is a consequence of the English lawmakers having a shared vision that bankruptcy law is not just the concern of creditors but affects the wider society.<sup>23</sup> This led to the acceptance that government has a supervisory role to play, and bankruptcy law is also viewed as a public policy measure. The link between the role of the state in protecting the public interest and the administration of bankruptcy estates is illustrated by the strong administrative features of the English regulatory framework and the institutional backing of bankruptcy law in general.<sup>24</sup> The administrative format of the English system also minimises the role of private attorneys in the general bankruptcy process, which distinguishes the English bankruptcy process from other lawyer-oriented systems such as the United States.<sup>25</sup>

The most comprehensive review of English insolvency laws in over a century was introduced *via* the Insolvency Act of 1986.<sup>26</sup> The provisions of the Act were largely based on the recommendations contained in the Cork *Report*<sup>27</sup> and entailed a far-reaching reconstruction of the law pertaining to both personal and corporate insolvency. The Insolvency Act 1986 was also responsible for introducing a number of watershed innovations to the regulatory model in place at the time and established the foundation for the regulatory and legislative framework of present-day bankruptcy law in England.<sup>28</sup>

At present, overall responsibility for the administration of insolvency law in England and Wales rests with the Department for Business, Innovation and Skills.<sup>29</sup> Within the Department this responsibility is discharged by members of the Insolvency Service under the overall

22 See also Evans *A Critical Analysis of Problem Areas in respect of Assets of Insolvent Estates of Individuals* (LLD thesis 2009 UP) 2; see also Calitz thesis part III on the various regulatory models adopted in the US and UK bankruptcy systems. Fletcher *The Law of Insolvency* (2009) 6-7; Levinthal "The Early History of English Bankruptcy" 1934 *University of Pennsylvania LR* 104; Milman *Corporate Insolvency Law and Practice* (1999) 2.

23 See Ramsay "Bankruptcy in Transition: The Case of England and Wales – the Neo-liberal Cuckoo in the European Nest?" in *Consumer Bankruptcy in Global Perspective* (ed Niemi-Kiesiläinen)(2003) 225.

24 Martin 2003 *American Bankruptcy Institute LR* 367.

25 See Calitz "Developments in the United States' consumer bankruptcy law: a South African perspective" 2007 *Obiter* 397.

26 Sealy *Annotated Guide to the Insolvency Legislation* (2004) 1.

27 Report of the Review Committee: *Insolvency Law and Practice, Report of the Review Committee* (Cmnd 8558) Chairman Sir Kenneth Cork GBE (1982) (Hereinafter referred to as *Cork Report*).

28 For a detailed discussion of the recommendations included in the *Cork Report* see Fletcher 18- 21; see also Ramsay "Functionalism and Political Economy in the Comparative Study of Consumer Insolvency: An Unfinished Story from England and Wales" 2006 *Theoretical Inquiries in Law* 625.

29 The Insolvency Service, an executive agency of the Department for Business, Innovation and Skills, mainly acts as the interface between government and the various stakeholders in insolvency law, and although the ultimate responsibility rests with the Secretary of State for the

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direction of the Inspector-General of the Insolvency Service.<sup>30</sup> The latter is responsible for exercising a controlling and supervisory function with regard to all official receivers and insolvency practitioners. The Insolvency Service, an executive agency of the Department for Business, Innovation and Skills, mainly acts as the interface between government and the various stakeholders in insolvency law, and although the ultimate responsibility rests with the Secretary of State for the Department for Business, Innovation and Skills, the day-to-day responsibility of supervision and control of the insolvency system is delegated to the Insolvency Service.

The English regulatory system can be classified as an administrative system, typified by the pervasive character of the government agency, as represented by the Insolvency Service.<sup>31</sup> At present, the public administrator is responsible for virtually all the key administrative decisions as well as for establishing detailed interpretations of statutory rules in bankruptcy law.<sup>32</sup> The core functions of the English public administrator have been identified as the administration of the insolvent estate by government-employed officials in the absence of a private-sector practitioner; focusing of resources on discharging the public interest functions of investigating and prosecuting the conduct of individual debtors and directors of failed companies; and, finally, authorising and regulating the insolvency profession. These features of a regulator are universal in almost all common-law systems, to a greater or lesser degree.

The clear message sent by the international community is thus that insolvency laws and systems are increasingly being recognised as a fundamental institution, essential for the development of credit markets and entrepreneurship in developing countries, and, in turn, those insolvency systems depend on the existence of sound and transparent institutional and regulatory frameworks.<sup>33</sup> In an era of globalisation of law that will inevitably accompany the globalisation of the economy, it is thus vital to any law reform effort to keep up with international trends and developments as we enter a phase in history where legal certainty and predictability are definite virtues.<sup>34</sup>

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30 See also <http://www.insolvency.gov.uk> (accessed 2011-07-31) for the official homepage of the Insolvency Service.

31 Ss 399-401 Insolvency Act 1986 and Pt 10 Insolvency Rules 1986.

32 See Martin 2003 *American Bankruptcy Institute LR* 367.

33 Cf Mistelis "Regulatory aspects: globalization, harmonization, legal transplants and law reform – some fundamental observations" 2000 *The International Lawyer* 1055. See further Joyce "The role of insolvency regulators in the past and in the future" (2003) unpublished paper presented at the International Insolvency Conference, Singapore. On file with the author. See *Principles for Effective Insolvency and Creditor Rights System* 5-8.

34 Mistelis 2000 *The International Lawyer* 1069.

### 3 State Regulation from a South African Perspective

#### 3 1 The Master of the High Court

In the South African insolvency law the Master of the High Court<sup>35</sup> (Master) is at present acting in a supervisory capacity with regard to the South African insolvency law in general.<sup>36</sup> The Master is appointed in terms of the Administration of Estates Act,<sup>37</sup> which includes the definition of the "Master" as follows:

"[I]n relation to any matter, property or estate, means the Master, Deputy Master or Assistant Master of a High Court appointed under section 2, who has jurisdiction in respect of that matter, property or estate and who is subject to the control, direction and supervision of the Chief Master."<sup>38</sup>

If we very briefly refer to the historical development of the institution of the Master we find that during the period of Roman-Dutch law, the establishment of the *Desolate Boedelkamers* and the Ordinance of Amsterdam, passed in 1777, which has widely been recognised as the origin of South African insolvency law, stand out as significant milestones.<sup>39</sup> During 1777 an insolvency Ordinance was granted to the city of Amsterdam, which, significantly, had been responsible for the introduction of the *Desolate Boedelkamers* charged, *inter alia*, with the administration of the estates of insolvent debtors.<sup>40</sup> The *Desolate*

35 Hereinafter referred to as the Master or the Master's office.

36 See Calitz thesis part III on the legal, regulatory and institutional frameworks within the South African insolvency law system.

37 Act 66 of 1965. The office of the Master is staffed by civil servants in the employ of the Department of Justice and Constitutional Development (Hereinafter referred to as the Department of Justice). Only persons with prescribed legal qualifications can be appointed as Master, Deputy Master or Assistant Master. The Administration of Estates Act 65 of 1966 (Administration of Estates Act) also makes provision for the appointment of a Chief Master who shall act as the executive officer of the Master's offices and exercises supervision over all the Masters as may be necessary to bring about uniformity in their practice and procedure. See Ss 2(1)(b); (2)(2) and 3(1) Administration of Estates Act. S (1) was substituted by s 14 Judicial Matters Amendment Act 16 of 2003 and by s 3 Judicial Matters Amendment Act 22 of 2005.

38 See definition of "Master" substituted by s 1(d) Administration of Estates Laws Interim Rationalisation Act 20 of 2001 and by s 2 Judicial Matters Amendment Act 22 of 2005. Notwithstanding the suggestion in the Master's title that there is an association with the courts, the Master is not part of the formal court structure and as such not appointed as an officer of the High Court. S 34(1)(a) Supreme Court Act 59 of 1959 provides for the appointment of officers of the Supreme Court (now High Court) but does not refer to the Master. See Bertelsmann *et al Mars: The Law of Insolvency in South Africa* (2008) 29.

39 Wessels *History of the Roman-Dutch Law* (1908) 667. See also Sharrock *et al Hockly's Insolvency Law* (2006) 11.

40 Ordinance 1777 (Amsterdam) *Nederlandsche Jaarboeken* 291.

*Boedelkamers* was a pioneering institution that served as a precursor to the Master of the High Court.<sup>41</sup>

Two significant events relating to the historical development of the Master occurred in 1828. The first occurred under the second British occupation of the Cape of Good Hope, when a Charter of Justice was issued in order to revise the judicial system, which made provision for the establishment of an independent "Supreme Court" and also *inter alia* confirmed that the court had to make provision for the post of a "Master of the Supreme Court".<sup>42</sup> The second noteworthy event occurred with the passing of the Ordinance of 1828, when for the first time it was mentioned that in future all insolvent estates had to be administered by an official referred to as the "Master of the Supreme Court".<sup>43</sup>

The present-day institution of the Master acts as a "creature of statute" and possesses only the powers the statute accords, whether expressly or by necessary implication.<sup>44</sup> If we thus align the institution of the Master of the High Court with international norms and standards as previously identified, it is particularly difficult to clearly define the role of the Master within the context of an international insolvency regulator. From a strategic point of view, we may argue that the Master's identity is that of regulator, as it does possess certain regulatory powers, such as applying its powers to compel an insolvency practitioner to act in the interests of the creditors.<sup>45</sup>

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- 41 See generally: Wessels 661; Smith *Insolvency Law* (1988) 5; Bertelsmann 1-2; Sharrock 11; Stander *Die Invloed van Sekwestrasie op Onuitgevoerde Kontrakte* (LLD thesis 1994 Potchefstroom University for Christian Higher Education) 8-16; Dalhuisen *Dalhuisen on International Insolvency and Bankruptcy* vol 1 (1986) 1-1-1-17; Visser "Romeinsregtelike Aanknopingspunte van die Sekwestrasieproses in die Suid-Afrikaanse Insolvensiereg" 1980 *De Jure* 42; Stander "Gesiedenis van die Insolvensiereg" 1996 *TSAR* 371; Levinthal "The Early History of Bankruptcy Law" 1918 *University of Pennsylvania LR* 223-250; Burdette (LLD thesis 2002 UP); Roestoff 'n *Kritiese Evaluasie van Skuldverligtingsmaatreëls vir die Individu in die Suid Afrikaanse Insolvensiereg* (LLD thesis 2002 UP).
- 42 The first Charter of Justice came into operation on 1828-01-01, spurred by the Proclamation of 1822-07-05, which made January 1827 the effective date for the use of English in the courts. The first Charter was subsequently followed by a second Charter, constituted by letter patent of 1832-05-04, and coming into operation on 1834-02-13, which superseded and modified it in certain aspects. See Theal *Records of the Cape Colony* (1898); Van der Walt *Geskiedenis van Suid-Afrika* (1961) 167. See further Kahn *A Review of the Recess System in the High Court* (2003) report prepared for the Department of Justice, Pretoria. On file with the author.
- 43 Ordinance of 1828. See Stander 1996 *TSAR* 376.
- 44 *CF*Bertelsmann 29. *Die Meester v Protea Assuransiematskappy Bpk* 1981 2 SA 685 (T) 690; *De Lange v Smuts* 1998 3 SA 785 (CC) 853; *The Master v Talmud* 1960 1 SA 236 (C) 238.
- 45 S 60(a)-(e) Insolvency Act 24 of 1936 (Insolvency Act). S 379 Companies Act 65 of 1973 regulates the removal of a liquidator; Sharrock 116. See further Rudolph *Student Manual: Applying the Promotion of Administrative Justice Act in Practice* (2009) 67.

It should also be noted that although the Master is generally responsible for the supervision of South African insolvency law, this is not the only discipline it has to contend with. In addition to the regulation of insolvency law, the Master has, *inter alia*, the following functions: supervising the administration of estates of deceased persons,<sup>46</sup> including the registration of wills; registration of trusts;<sup>47</sup> supervising the administration of estates of minors and legally incapacitated persons as well as the administration of the "Guardian's Fund", where unclaimed moneys and certain funds of minors and incapacitated persons are held in reserve.<sup>48</sup>

### 3 2 Problems Relating to State Regulation of South African Insolvency Law

In recent years there has been a great deal of debate surrounding the Master's reputation as insolvency regulator, which in turn has led to this field of law increasingly being the subject of scholarly articles, reflection and debate.<sup>49</sup> On a larger scale the present predicament is that the Master is burdened with the task of preserving the integrity of the law relating to insolvency matters without having the necessary legal and infrastructural resources and institutional capacity to support this undertaking.<sup>50</sup>

The legal framework within the South African insolvency law results in the Master being involved and entangled in various technical issues relating to the administration of the insolvent estate. Consequently, the Master does not prioritise matters of a public nature, such as the investigative aspect of the cause of insolvency or being involved in the development of general insolvency policies and law reform, as these represent matters which fall outside the Master's statutory agenda.<sup>51</sup> Due to its multifarious character, the Master finds itself in the midst of certain challenges relating to the regulation of insolvency law. This state of

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46 See Administration of Estates Act and Wills Act 7 of 1953 on the various statutory powers and duties of the Master.

47 Trust Property Control Act 57 of 1988.

48 See ss 76 (1) (b) and 86-93 Administration of Estates Act and Mental Health Care Act 17 of 2002. In terms of the Prevention of Organised Crime Act 121 of 1998, where the court has authorised the attachment of such assets by the Asset Forfeiture Unit, it appoints a curator to administer the assets. The appointed curator, however, has no authority to act as such until duly authorised by the Master.

49 Loubser "An international perspective on the regulation of insolvency practitioners" 2007 *SA Merc LJ* 123; Calitz "The appointment of insolvency practitioners in South Africa: time for change?" 2006 *TSAR* 721. See Burdette "Reform, regulation and transformation: the problems and challenges facing South African insolvency industry" (2005) unpublished paper presented at the Commonwealth Law Conference, London. On file with the author.

50 See Calitz thesis part V on the legal, regulatory and institutional frameworks within the South African insolvency law system as well as a detailed discussion of the powers and duties of the Master.

51 See Calitz thesis part VI for a discussion of the public interest aspect of insolvency law.

affairs is not only unproductive but also in direct contrast to the government's skills development policies.<sup>52</sup> In a recent keynote address the acting Chief-Master acknowledged the following:

The workload in those two offices has, not surprisingly, increased at a phenomenal rate. The rightsizing initiative and filling of vacancies have inevitably resulted in the appointment of many new staff members who are still in the process of finding their feet.<sup>53</sup>

The lack of specialisation in the office of the Master combined with the lack of resources not only has an impact on service delivery, but also prevents the Master from effectively acting out the Constitution's commitment to "an efficient, equitable and ethical public administration which respects fundamental rights and is accountable to the broader public".<sup>54</sup> A good illustration of this allegation can be found in the case of *Moseneke v The Master*,<sup>55</sup> where the Master opposed the application on considerations which included:

- (a) The lack of human resources, infrastructure, training and finance to administer the intestate estates of Blacks.
- (b) The current workload of the masters of the high court which already provides substantial pressure and managerial problems.
- (c) The transferral of intestate Black estates from the magistrate's to the master's office would create chaos.<sup>56</sup>

Another disparity that one notices when examining the functions of the Master within the context of international standards is the lack of investigative powers of the Master relating to the cause of the insolvency. In most foreign jurisdictions the investigation into the cause of insolvency, which also includes the behaviour of the insolvent prior to the sequestration of his estate, represents a major objective in the justification of these regulatory institutions.<sup>57</sup> Customarily, the investigative process of insolvency law is also established as a public policy measure. Although the South African system hosts a strong

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52 See Skills Development Act 97 of 1998.

53 Basset "His master's voice: a message from the regulator" (2009) unpublished paper presented at the AIPSA Conference, Johannesburg. On file with the author.

54 See *President of RSA v SARFU* 2000 1 SA 1 (CC) at par 133. See further Hoexter *Administrative Law in South Africa* (2006) 14.

55 2001 2 SA 18 (CC). The case dealt with the constitutionality of certain provisions of the Black Administration Act 38 of 1927.

56 *Moseneke v The Master supra* par 14.

57 In the UK the Insolvency Service's Companies Investigation Branch ("CIB") investigates serious corporate abuse using compulsory powers under the Companies Act 1985. See also ss 235 and 236 Insolvency Act 1986 (Hereinafter referred to as the Insolvency Act 1986 or the Insolvency Act of 1986). Although it received the Royal Assent and became law on 1985-10-30, the government decided to delay implementation of all but a few of its provisions and to draw up a new Act, consolidating its provisions with those parts of the Companies Act 1985 dealing with receivership and winding-up. This became the Insolvency Act 1986. The Act received Royal Assent on 1986-07-25 and was brought into force on 1986-12-29.

interrogation procedure,<sup>58</sup> the investigative powers of the Master are limited to the general enquiries afforded by the Act, which generally aims to obtain information on the financial affairs of the insolvent and the whereabouts of property.<sup>59</sup> Being able to determine the cause of insolvency not only has the advantage of separating the *bona fide* insolvent from the person abusing the system, but in the context of law reform will also have substantial scientific and empirical value.

It would be fair to state that over the years one of the Master's more controversial duties has been the appointment of a provisional trustee or liquidator in an insolvent estate.<sup>60</sup> It is interesting to note that the 1916 Insolvency Act,<sup>61</sup> predecessor to the current Act, granted the Court a discretion to appoint a provisional trustee prior to appointing a final trustee, or when the trustee has been removed, or is not acting as such.<sup>62</sup> With the enactment of the current 1936 Insolvency Act<sup>63</sup> the responsibility to appoint a provisional trustee was however removed

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58 Within South African insolvency law there are different types of interrogations which can as a rule be divided into public and private enquiries. The Insolvency Act provides for three different types of interrogations: the provision primarily aimed at investigating the validity of claims lodged for proof at a meeting of creditors (s 42 Insolvency Act) a creditor's enquiry in order to investigate the affairs of the insolvent (ss 64, 65 and 66 Insolvency Act) and a private Master's enquiry in terms of the provisions of s 152. Corresponding provisions contained in the Companies Act also provide for public enquiries by creditors, (ss 415 and 416 Companies Act) and provisions relating to private enquiries before the Master or a Commissioner appointed by the Master or the Court (ss 417 and 418 Companies Act). See Bertelsmann 418.

59 The UK's Cork Committee was a strong advocate of having a robust investigation procedure, linking the idea to maintaining public confidence in the ability of the bankruptcy system to weed out abuse. The investigatory function rests with the official receiver, who investigates an individual debtor as well as officers and directors of companies. If at any time the Master is of the opinion that the insolvent or the trustee of that estate or any other person is able to give any information which the Master considers desirable to obtain, concerning the insolvent, or concerning his estate or the administration of the estate or concerning any claim or demand made against the estate, he may by notice in writing delivered to the insolvent or the trustee or such other person summon him to appear before the Master or before a magistrate or an officer in the public service mentioned in such notice to deliver all the information within his knowledge concerning the insolvent or concerning the insolvent's estate or the administration of the estate. S 152(1) Insolvency Act; s 381 Companies Act. Section 381(2) Companies Act provides that the Master may at any time in relation to any winding-up examine the liquidator or any other person on oath concerning the winding-up. See Calitz thesis part V par 327.

60 S 18 Insolvency Act.

61 Act 42 of 1916 (Hereinafter referred to as the Insolvency Act of 1916 or the 1916 Insolvency Act).

62 S 57 1916 Insolvency Act.

63 It is important to note that however complete the Insolvency Act may be, it did not totally repeal the common law in respect of South African insolvency law, and that English law played an important role in the development of our insolvency law.

from the courts and the Master at present possesses the power to appoint a provisional trustee.<sup>64</sup>

Although the Insolvency Act states in the negative the qualifications of a trustee by declaring which persons are disqualified from acting as a trustee, it fails to state the criteria for making such an appointment.<sup>65</sup> This effectively confers on the Master a discretion as to the method and the identity of the person appointed as the provisional trustee of an insolvent estate.<sup>66</sup> Although the Insolvency Act sets out certain disqualification criteria for the appointment of trustees,<sup>67</sup> it does not categorically state who should be appointed by the Master as a provisional or final trustee. In order to circumvent the lack in statutory guidelines the Master, of his own accord, has over the years implemented certain measures such as the use of a register to which he could add the names of persons who, in his view, qualified as persons suitable for appointment as trustees.<sup>68</sup> Another informal measure had been the development of a policy document with regard to the criteria which should be followed when making a provisional appointment. The main point of concern, however, remains the legality of the Master's measures which could be vulnerable to any litigation challenging its constitutionality.<sup>69</sup>

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64 S 18(1) Insolvency Act. See Calitz 2006 *TSAR* 721. See further Cronje *et al Study Notes: Diploma in Insolvency Law and Practice* (2011) ch 19.

65 S 55 Insolvency Act.

66 In *Krumm v The Master* 1989 3 SA 944 (D) reference was made to a Master's Instruction which stated that because of possible bias a wide range of candidates may not be considered for appointment. The court stated that the exercise of a discretion by the Master to appoint a provisional liquidator could only be attacked on review on the basis that the Master failed to exercise his discretion at all, that he acted *mala fide*, or was motivated by improper considerations. The court held that it was not grossly unreasonable for the Master to issue and apply a directive such as the one which he did in the matter. The court concluded with the following (952F-G): "His (the Master's) approach may be said to be over-cautious, but is it not better that, if he should err, he should do so on the side of caution?" It is submitted that this decision may be influenced by s 33 of the Constitution, which provides that administrative action should be justifiable in relation to the reasons given for it. A court may order the Master to exercise his discretion properly, but will only in exceptional circumstances substitute its own decision for that of the Master. *Cf UWC v MEC for Health and Social Services* 1998 3 SA 124 (C) at 130F. See also Cronje 129.

67 See s 55 Insolvency Act for a list of these disqualifications.

68 Over time this became known as the "Master's panel". In order for one's name to be added to the register, or in order to be placed on the "Master's panel", prospective trustees have to make application to the relevant Master's office. Although each Master's office has a different *modus operandi* when it comes to the placement of prospective trustees on the panel, the procedure usually consists of the submission of certain documentation to the Master, and a subsequent interview of the candidate by a panel consisting of personnel from the Master's office, and one or more practising practitioners who represent either the Association of Insolvency Practitioners of Southern Africa (AIPSA) or the Association for the Advancement of Black Insolvency Practitioners (AABIP) (or both).

69 Burdette "Reform, Regulation and Transformation" 8.

In 2003 the Minister of Justice and Constitutional Development, reacting to persistent allegations of corruption in the appointment of insolvency practitioners, introduced a Judicial Matters Amendment Act.<sup>70</sup> This amendment to the current Act authorises the Minister of Justice and Constitutional Development<sup>71</sup> to determine a policy for the appointment of insolvency practitioners by the Master.<sup>72</sup> The objective behind the amendment of the Act was thus to incorporate the principles of a previous "informal" policy document into legislation.<sup>73</sup> Informal discussions with various stakeholders indicate that the Department of Justice is in process of finalising the policy document; however, no official document or request for commentary has yet been published.<sup>74</sup>

Finally, the insolvency profession is, and always has been, one of the few unregulated professions in South Africa. Although it has been indicated that the regulatory aspects of the insolvency practitioner fall outside the scope of this study, the interplay between the regulatory body and office holder represents an important part of the concept of a regulatory framework. As already indicated, the regulation of the insolvency profession lacks an adequate regulatory framework. In a

70 Act 16 of 2003. In *Beinash & Co v Nathan (Standard Bank of SA Ltd Intervening)* 1998 3 SA 540 (W), Flemming DJP confirmed the view that some liquidators acted dishonestly when he stated that liquidators and trustees were regarded by many as ineffective and "even sometimes disrespected in regard to integrity" at 545D. See Loubser 2007 *SA Merc LJ* 123.

71 Hereinafter referred to as the Minister or the Minister of Justice.

72 The relevant power was inserted into s 158(2)-(3) Insolvency Act, s 15(1A) Companies Act and s 10 Close Corporations Act, respectively. The stated aim of the legislation was first to create uniform procedures in all Masters' offices for the appointment of these functionaries and thus to promote the image of the insolvency practitioners and of the Master's division, and secondly to promote consistency, fairness, transparency and the achievement of equality in these appointments by the various Masters. See Memorandum on the Objects of the Judicial Matters Amendments Bill (2003) at par 2.2. See Loubser 2007 *SA Merc LJ* 125.

73 It is not clear when the policy document was implemented for the first time. The original policy document is termed *Policy: Strategy on/procedures for appointment of liquidators and trustees*. The document would appear to have been implemented in 1998 or 1999. The document deals not only with the appointment of trustees and liquidators, but also *inter alia* with topics such as the training and the lodging of requisitions. On file with the author. One concern is that the legislative amendments provide for the application of a policy document that has been accepted and approved of by Parliament. To date this has not been done. Other attempts to finalise the Minister's policy document include certain "draft documents" which from time to time had been made available to certain role-players in the industry and include: Department of Justice and Constitutional Development *Division: Master of the Court Policy: Strategy on/procedures for the Appointment of Liquidators and Trustees* (June 2001); *Chief Masters Directive – The appointment of Liquidators* (2007); *Minister's Policy Guideline on the Appointment of Liquidators, Curator Bonis, Trustees and Judicial Managers* (2007). On file with the author. See also Calitz 2006 *TSAR* 721.

74 The Department of Justice is apparently in the process of finalising the policy document as referred to in s 158 Insolvency Act.

recent keynote address the Deputy-Minister of Justice and Constitutional Development also acknowledged the importance of regulation of the insolvency industry and especially the importance of building institutional capacity. He stated that: "[t]he current economic climate dictates that we have an industry that is regulated properly and regulated soon."<sup>75</sup>

Literature on the regulation of insolvency law suggests that in the absence of a sophisticated regulatory framework, the role of the regulatory body becomes more important.<sup>76</sup> Consequently, it is submitted that South Africa lacks a sufficient regulatory framework with regard to the regulating and monitoring of insolvency practitioners, and as a result legitimate concerns could be raised about whether there are sufficient regulatory safeguards in place to ensure that only impartial insolvency practitioners with the necessary experience are appointed to act as office holders.<sup>77</sup> The absence of a proper regulatory framework and a specialised regulator could result in the general ineffectiveness of the South African insolvency system as a whole.

As has already been established, the Master acts as regulator in South African insolvency law, but is limited in power and scope to the functions and powers granted within the four corners of the Insolvency Act.<sup>78</sup> In comparison with the profile outlined in international instruments such as the World Bank's *Revised Draft Creditors Rights and Insolvency Standards*, the Master lacks the discretion and the authority of an authentic regulator.<sup>79</sup> According to its statutory purpose, the priority of the Master lies very much in protecting the interest of creditors through

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75 Keynote address by Deputy Minister of Justice and Constitutional Development, Mr Andries Nel, MP, at the International Association of Insolvency Regulators (IAIR) annual general meeting and conference, Sandton, 2009.

76 Mensah *et al African Emerging Markets: Contemporary issues* (2001) on economic regulatory frameworks.

77 It is the view of various academic scholars in South Africa that the present regulatory regime is inadequate and in desperate need of reform. Loubser 2007 *SA Merc LJ* 126 comments that: "The situation at the moment is that no qualifications, whether academic or practical, no experience and no professional affiliation are required by law. As a result, there is virtually no control over or disciplinary action against negligent, dishonest or incompetent insolvency practitioners". In *Beinash & Co v Nathan (Standard Bank of SA Ltd intervening)* 1998 3 SA 540 (W) 545D, Flemming DJP confirmed this view when he stated that the liquidators and trustees were regarded by many as ineffective and "even sometimes disrespected with regard to integrity". The many media reports concerning allegations of corruption and fraud against practitioners as well as the Master's personnel have certainly done nothing to change this widely held view. See eg, *Sunday Times Business Times* (2004-03-24) 1; *Sake Beeld* (2004-03-24) 14; *Business Day* (2004-04-22) 1; "Liquidation industry rife with corruption" *Independent online* (2003-10-12). See also Loubser 2007 *SA Merc LJ* 126.

78 See Calitz "The role of the Master of the High Court as regulator in a changing liquidation environment: a South African perspective" 2005 TSAR 728.

79 See *supra* (n 10).

the legislative powers granted to it, in contrast to the more influential role of international regulators, who act to protect the rights of creditors and furthermore to protect the public interest. It is thus submitted that if we consider the international perspective on state regulation as well as the new constitutional dispensation, the state regulation in the South African insolvency law has become obsolete and out of sync with general international and local demands.<sup>80</sup>

### **3 3 Law Reform Proposals with Regard to State Regulation in South African Insolvency Law**

The South African Law Commission (the Commission) reviewed the South African law of insolvency in the late 1980s, and has published a number of working papers for discussion, reports as well as draft legislation.<sup>81</sup> In 2003 the Cabinet of South Africa approved the Draft Insolvency and Business Recovery Bill,<sup>82</sup> and it was handed over to the Chief State Law Advisers for final certification before being referred to Parliament. However, before the certification process could be completed the absence of a business rescue model was brought to the Department of Justice's attention and the process came to an abrupt halt.<sup>83</sup> The new Companies Act<sup>84</sup> has however now come into effect on 1 May 2011, and contains a chapter on business rescue provisions for companies.<sup>85</sup> As this obstacle to implementing new insolvency legislation has now been removed, it is expected that steps to table new insolvency laws in Parliament will be revived, and a task team of the National Economic Development and Labour Council has also finalised a draft report on the Bill.<sup>86</sup>

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80 See Calitz thesis part III for a detailed discussion of state regulation of insolvency law from an international perspective.

81 In 1999 the South African Law Commission published its second draft Insolvency Bill and explanatory memorandum. This explanatory memorandum and draft Bill were however officially published in 2000. The previous draft Bill was published for comment in 1996 as the Review of the Law of Insolvency. See *Draft Insolvency Bill and Explanatory Memorandum Working Paper 66; Project 63* (1996) (Hereinafter referred to as 1996 draft Bill and explanatory memorandum). See South African Law Commission, *Project 63, Commission Paper 582 Review of the Law of Insolvency* (2000) vol I & II (hereinafter referred to as Commission Paper).

82 The name awarded to the draft Bill when it was envisaged that the Business Rescue provisions for corporate entities would form part of the Insolvency Act.

83 See Burdette "Reform, Regulation and Transformation" 10. The final draft Unified Bill has not yet been officially published by the Law Reform Commission and as such the original draft Bill included in the 2000 South African Law Commission Report remains the only official version reflecting the changes proposed by the Law Reform Commission. Consequently this study will henceforth refer to the 2000 version of the Bill.

84 71 of 2008.

85 See ch 6 Companies Act 71 of 2008.

86 At the date of this publication the draft report has not been made public.

The tenor of the Commission's Draft Insolvency Bill<sup>87</sup> suggests that the government, at the time of issuing its report in 2000, was evidently not prepared to make the paradigm shift to bring about a change to the underlying policy and overall structure of the regulatory framework of South African insolvency law.<sup>88</sup> When the Explanatory Memorandum to the draft Bill is perused for amendments or revisions of the current policy and *status quo*, one of the substantive changes linked to the regulatory system is the acceptance by the Commission as a general premise that creditors should accept responsibility for the protection of their own interests.<sup>89</sup> The Master, however, retains its role as supervisor of the South African insolvency law and the proposals with regard to the powers and duties of the Master could at best be described as practical or technical.

There are a few recommendations in the Commission's report which have the effect of reducing the role of the Master in insolvency law.<sup>90</sup> Given the acknowledgement of consistent rumours of undue influence with regard to appointment procedures in the Master's office, and admission that the dominance of one group of creditors in the administration and appointment process of the estate holds a threat, proposals that the liquidator should be appointed by the court were rejected.<sup>91</sup> The Commission submitted that it would be more difficult to review a process where someone other than a public official such as the Master is alleged to be at fault. It therefore viewed it advisable to limit the discretion of the Master rather than remove it completely.<sup>92</sup>

Another significant new provision included in the draft Bill is the power bestowed on the Master to suspend a liquidator on the strength of a complaint made to him on affidavit or if the person has been charged with an offence, pending the investigation into the suitability of the liquidator to remain in office.<sup>93</sup> It is clear from the draft Bill that the investigation should be undertaken by the Master, but the clause fails to give any detail as to the nature and scope of the Master's power to investigate. Given the impact this proposal would have on the Master's resources, it is unfortunate that the Commission did not use the opportunity to include specific guidelines. It is also unclear whether the constitutionality of such an investigation into the rights of the individual had been carefully considered.

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87 *Supra*.

88 See Burdette *A Framework for Corporate Insolvency Law Reform in South Africa* (LLD thesis 2009 UP) 656. See also Boraine "Fresh Start Procedures for Consumer Debtors in South African Bankruptcy Law" 2002 *International Insolvency Review* 1.

89 Explanatory Memorandum 14.

90 *Idem* 12.

91 *Idem* 101.

92 *Idem* 101.

93 Cl 58(2) draft Bill.

With regard to the regulation of the insolvency industry some of the more substantive changes proposed to the existing position recommended in the report of the Commission is that only a person who is a member of a professional body recognised by the Minister of Justice may be appointed as liquidator.<sup>94</sup> In clause 53(2) of the draft Bill the following is stated: "The Minister may from time to time publish by notice in the *Gazette* the name of a recognized professional body if it appears to him or her that such body regulates the practice of a profession and maintains and enforces rules for ensuring that a member of such body is a fit and proper person to be appointed as liquidator and meets acceptable requirements for education and practical experience and training".<sup>95</sup> Liquidators may also preside at meetings of creditors unless questioning is to take place at the meeting, or an interested party requests that the Master of the High Court or a magistrate should preside.<sup>96</sup>

The advantage of the law reform processes conducted by the Commission thus far has been that apart from the considerable amount of research that has been done over the years, the Commission has also managed to build up a wealth of expertise, knowledge and specialist contacts. Not only does the process of law reform require specialist advice in the planning and formulation of law reform, but continuity enables the Commission to acquire and apply the expertise and the resources that it has acquired over the years. The Commission should also perhaps not be criticised too harshly for not having a bold approach to the regulatory aspects of the insolvency law, as it has the difficult task of combining, on the one hand, an innovative approach which can lead to ground-breaking work and radical law reform proposals and, on the other hand, the high standards which are needed to gain the respect of those with whom they deal.<sup>97</sup>

The key objective of any law reform proposal should be not only to be compatible and harmonious with international best practice in the field of law, but also to incorporate the legal, economic and social context of a contemporary South Africa. It is submitted that although certain aspects of the investigation of the Commission contain recommendations that have been thoroughly worked through, a fresh approach to the subject of state regulation of insolvency law supported

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94 Cronje "Country Report for South Africa" unpublished paper presented at the World Bank Global Judges Forum, (2003) at [http://siteresources.worldbank.org/GILD/ConferenceMaterial/20157439/South%20Africa%20CR%20-%20Final%20Version%20%20\(Per%20LK%204-8\).pdf](http://siteresources.worldbank.org/GILD/ConferenceMaterial/20157439/South%20Africa%20CR%20-%20Final%20Version%20%20(Per%20LK%204-8).pdf) (accessed 2011-07-31).

95 This clause is partially based on the UK's model of regulation. See Calitz "System of regulation of South African insolvency law: lessons from the United Kingdom" 2008 *Obiter* 352.

96 Cl 41(3) draft Bill.

97 See also paper by Commonwealth Secretariat on "Law Reform Agencies: Their Role and Effectiveness" (2005) Accra Ghana at [http://www.calras.org/Other/secretariat\\_paper.pdf](http://www.calras.org/Other/secretariat_paper.pdf) (accessed 2011-07-31).

by a policy-based methodology is required. When assessing the present state of the law of insolvency the following statement very aptly articulates this above notion:

This will probably mean that the old pre-Constitution jurisprudence will need to be read with circumspection – practitioners and courts should no longer be entitled to simply rely on this old case law as authority. Each and every pre-Constitutional precedent will need to once again be scrutinized, this time against the values that permeate through the Bill of Rights, so as to make sure that all law (including case law) is constitutionally compliant. That it is our duty to do this is beyond question – the common law must be developed so that it is brought into line with our Constitution.<sup>98</sup>

Although a detailed discussion of the new legislation on company law falls beyond the scope of this article, it is interesting to note that the new Companies Act 71 of 2008<sup>99</sup> contains a chapter dealing with company business rescue provisions.<sup>100</sup> In terms of the Act a business rescue practitioner is required to be appointed in order to give effect to and to implement these proceedings, thus introducing a new profession to the South African commercial landscape – namely that of the business rescue practitioner.<sup>101</sup> Section 138(1)(a) of the Companies Amendment Act<sup>102</sup> and the Companies Regulations require candidates to qualify as business rescue practitioners by either being (i) a member of one of the accredited professions, or (ii) licensed by the Companies and Intellectual Property Commission (CIPC).<sup>103</sup> According to section 138(1)(a) one of the requirements for an individual to be appointed as a business rescue practitioner of a company is that the person is a member in good standing of a legal, accounting or business management professions

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98 Hopkins "The Influence of the Bill of Rights on the Enforcement of Contracts" August 2003 *De Rebus* 22.

99 Act 71 of 2008. The new Companies Act was signed by the President on the 2009-04-08 and gazetted in Gazette No. 32121 (Notice No. 421). The effective date of the Companies Act, 2008, was gazetted in GG No 34239 of 2011-05-01.

100 See ch 6 Companies Act 71 of 2008.

101 See Rushworth "A critical analysis of the business rescue regime in the Companies Act 71 of 2008" in *Modern Company Law for a Competitive South African Economy* (ed Mongale)(2009) 375.

102 Companies Amendment Act 3 of 2011.

103 The English text of s 138(1)(a) as amended by s 88 Companies Amendment Act 3 of 2011 is in conflict with the Afrikaans text as well as with the Companies Regulations 2011, as to who qualifies as business rescue practitioners. In terms of the Afrikaans version of the Act in order to be appointed as a business rescue practitioner a person has to be a member of an accredited profession "or" be licensed as such by the CIPC. The President signed the incorrect English version of the Companies Amendment Act referring to "(i) a member of one of the accredited professions, and (ii) licensed by the Commission". Reg 126(1)(b) Companies Regulations 2011 clearly provides that if a person is a member of an accredited profession such person does not have to apply for a licence. See "Corporate Renewal Solutions on the new Business Rescue provisions" at <http://www.business-rescue.co.za/index.php> (accessed 2011-07-31).

accredited by the CIPC.<sup>104</sup> At the date of writing this publication little progress has been made by the CIPC in the accreditation of any legal, accounting or business management professions. It can however be expected that attorneys and chartered accountants will ultimately be accredited, but it is still uncertain how the concept of "business management profession" would be interpreted.<sup>105</sup> It will also be interesting to see whether South Africa has enough appropriately skilled and experienced people who can function as business rescue practitioners and how the regulation of this latest profession will play out.

## **4 Proposals for Law Reform with Regard to State Regulation of South African Insolvency Law**

### **4 1 General**

Before embarking on a discussion on proposals for the development of a regulatory framework within the South African insolvency regime, it is necessary to make a few remarks regarding the subject of law reform. Now that the global norms and standards have clearly been articulated by the World Bank and organisations such as UNCITRAL, it should become a priority to examine ways of adapting them to a South African context.<sup>106</sup> In order to achieve these objectives, policy- and lawmakers will have to negotiate a satisfactory resolution between global norms and standards which would be acceptable on an international level, while also anticipating the difficulties that could arise out of the political and economic realities of a developing country with unique commercial and legal issues. The challenge will lie in creating a balance between, on the one hand, designing a model which will optimise the regulatory outcome, while, on the other hand, bear in mind that this should take place within an achievable and sustainable environment.

It is submitted that in order to create an effective and efficient regulatory model a complete and comprehensive overhaul of the South African insolvency law regime in general should occur.<sup>107</sup> Although this is ambitious, such a rigorous approach would afford national policy- and lawmakers the opportunity to embark on a comprehensive policy-based investigation of the South African insolvency law in general. An holistic approach to insolvency law reform would not only have the advantage of questioning the degree of harmonisation or convergence with insolvency regimes in other jurisdictions, but also ensure that the implementation of various policy considerations and law reform initiatives will be placed on a firm constitutional footing. If, however, a piecemeal approach is to be

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104 Reg 126 Companies Regulations 2011 describes the application process to be licensed.

105 Bradsheet "The Leak in the Chapter 6 Lifeboat: Inadequate Regulation of Business Rescue Practitioners May Adversely Affect Lenders' Willingness and the Growth of the Economy" 2010 *SA Merc LJ* 195.

106 See Calitz thesis part III ch 5 for a detailed discussion.

107 See Calitz thesis part V; part VII ch 3 for a detailed discussion.

adopted, it is submitted that any regulatory law reform objective should be complementary to, and compatible with, the South African commercial environment as a whole.

Any institutional reform initiative will however have to take cognisance of several challenges which could be encountered along the way. Apart from the cost implication and other resource constraints, issues such as institutional capacity, social, cultural and historical factors and political economy aspects may also feature. Thus, as a result of the sheer gravity of introducing such institutional change, it becomes even more important to introduce an initial policy process in order to conduct a realistic appraisal of the project, identify those factors that could influence policy outcomes and develop a policy containing clear and consistent objectives.<sup>108</sup> In rethinking the structure of the regulatory system in our insolvency law, policy- and lawmakers will have the opportunity to reform the process and to develop a streamlined and effective system in line with international standards and guidelines.

"It is a now a truism to affirm that in all lawmaking a gap opens between on the books and law in action."<sup>109</sup> It is precisely this gap that should represent a central focus theme in development of policy with regard to the regulatory framework in our insolvency law. It is increasingly recognised by scholars that the effectiveness of any insolvency law relies heavily on the institutions of implementation.<sup>110</sup> One of the principal decisions that will have to be made in the design and implementation of a regulatory regime is whether the Master as supervisory body should continue to exist, albeit in a revised shape, or whether a complete and independent regulatory agency should be introduced into our insolvency law.<sup>111</sup>

The positive aspect of persisting with the Master as regulatory authority is that the centuries-old institution will remain "as is", and no institutional or legislative changes will have to be considered. Henning<sup>112</sup> makes a very relevant statement when he mentions that law reform should take place for the right reason. He relates the story that business entity reform in South Africa was a response to the economic and political situation in the nation. It is submitted that the ultimate criterion

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108 Ball *Security Sector Governance in Africa: A Handbook* (2004) Centre for Democracy and Development, London par 4.6.1. at [http://www.ssronline.org/ssg\\_a/index.cfm?id=41&p=41](http://www.ssronline.org/ssg_a/index.cfm?id=41&p=41) (accessed 2011-07-31).

109 Halliday 17.

110 Ngok "Law-making and China's Market Transition Legislative Activism at the Eight National People's Congress" in *Problems of Post-Communism* (ed Pistor)(2002).

111 Halliday 17.

112 See Vestal "Business Law Reform in South Africa: The Right Path, The Right Reason" 2002 *Kentucky LJ* 829.

See also Henning "Reforming Business Entity Law to Stimulate Economic Growth among the Marginalized: The Modern South African Experience" 2003 *Kentucky LJ* 91.

should be whether it is possible for the Master to emerge as an efficient and effective institution capable of installing commercial trust.

The remaining option entails establishing and implementing a new independent and complete regulatory agency, responsible for overseeing and implementing the regulatory procedures in our insolvency law. The international profile of a regulatory body ranges from a government department or agency to a professional body or a combination of the two. Against this background, the following statement by Halliday<sup>113</sup> is significant:

... the implementation and institution building are as important as – indeed arguably more consequential than – formal lawmaking. It is a dangerous illusion that the legal framework and institutions of an effective insolvency system can be done cheaply. Effective bankruptcy systems require the careful design, infrastructural expenditure, and political will comparable to major infrastructural projects in transportation or energy or defence. This is especially so in circumstances where there is rapid economic development and social dislocation in a society that had previously invested little in legal institutions. Failure of government to act boldly and decisively can lead not only to incapacity but instability in society and ultimately the market.

## 4 2 An Independent Regulatory Body

### 4 2 1 General

It is submitted that, given South Africa's unique political, social and economic situation, it is inevitable that the state should be involved in the regulatory process. Despite the challenges identified in our present regulatory system, it is proposed that the state nevertheless plays a significant role in the regulatory framework of the South African insolvency system, albeit in a completely revised form. The public interest has been a vital component of insolvency regulation since the earliest days and continues to occupy a position of prominence.<sup>114</sup> Apart from protecting certain vulnerable groups within society, the state also has a legitimate interest to ensure that the institution of credit, the lifeblood of the economy, is not abused. A combination of factors relating to *inter alia* our emerging market economy as well as the unique socio-political dynamics contributes to the recognition that the regulatory aspects of insolvency law represent a considerable social concern that cannot simply be outsourced to the private sector.

Drawing on the conclusion that the state has to be engaged in the regulatory regime, the next key issue to be addressed is thus in which format the state should become involved, and within a South African context this subject involves the future role of the Master of the High Court in a regulatory landscape. As a result of the challenges identified

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113 Halliday 41.

114 The Cork *Report* par 1734 concluded that: "Insolvency proceedings have never been treated in English law as an exclusive private law matter between the debtor and his creditors; the community itself has always been recognised as having an important interest in them."

earlier in this study and especially the lack of public confidence in the current conduct of the Master,<sup>115</sup> it is submitted that the Master cease acting in a supervisory capacity with regard to insolvency law and disassociate itself therefrom. It is submitted that the Master should continue to exist as a government institution charged with some of the duties it presently performs, for example the administration of deceased estates, including the acceptance and custodianship of wills; protection of the interests of minors and legally incapacitated persons; controlling the registration and administration of both testamentary and *inter vivos* trusts as well as management of the Guardian's Fund. This approach would mark a return for the Master to its roots as the "Master of the Orphan Chamber".<sup>116</sup> This recommendation would ensure that the Master would be able to focus on the protection of the interests of minors and other vulnerable groups and would thus align its functions more closely with the values entrenched in the Constitution within the current socio-economic circumstances in South Africa.<sup>117</sup>

In the place of the Master's current supervisory role it is submitted that a new regulatory agency in insolvency law should be established which would fulfil the role of a complete "insolvency regulator" in insolvency law. The new independent regulatory authority would not only aim to ensure some degree of harmonisation and convergence with insolvency regimes in other jurisdictions, including important trading partners and sources of investment, but also foster more local and international confidence in our insolvency law system, by more closely mirroring the values reflected in the Constitution.<sup>118</sup>

#### **4 2 2 Suggested Framework of an Independent Regulatory Body**

The new independent office, which for present purposes we could refer to as the "Superintendent in Insolvency", would preferably operate as an independent Business Unit within the Department of Justice and Constitutional Development. It is recommended that the Superintendent as such should be a person of high standing with established credentials in insolvency administration and preferably hold the trust and confidence of the national commercial community. The organisational structure and design of the institution could be loosely based on the English Insolvency Service, which at present is constituted as an Executive Agency of the Department of Business, Innovation and Skills.<sup>119</sup> As previously mentioned South African insolvency legislation is deeply rooted in English law, resulting in South African and English laws

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115 See Loubser 2007 *SA Merc LJ* 123.

116 Also referred to as the "*Weesheer*".

117 See Calitz thesis part VII for a detailed recommendation and proposal on a regulatory framework for the South African insolvency law.

118 See Calitz thesis part VII for a detailed discussion on the constitutional and administrative law aspects of state regulation of South African insolvency law.

119 The key provisions are to be found in ss 399-401 Insolvency Act 1986 and Part 10 of the *Insolvency Rules* 1986.

reflecting to a great extent similar legal philosophies and principles.<sup>120</sup> Although the English regulatory framework as encapsulated within the present Insolvency Act 1986<sup>121</sup> may not suit the South African economic conditions in a strict sense, there are adequate similarities between the two jurisdictions' historical, legal and cultural elements to constitute a distinct and identifiable practice. It is submitted that the state's role in the regulatory aspects of the law should be confined to issues which are truly public in nature and which could not be adequately performed by the creation of adequate incentives for private practitioners in the insolvency process. This approach would strike the correct balance between state and private sector interest in a country with a unique legal and socio-economic environment.<sup>122</sup>

It is proposed that the most prominent feature associated with the new regulatory agency should be to act as a truly independent role-player in insolvency law. According to international norms and standards the hallmarks of a regulatory system should be clarity, transparency and fairness, predictability and accountability.<sup>123</sup> On the basis of the converging elements identified, the key bankruptcy functions of the office of the Superintendent are recommended as: enquiry and enforcement to deal with the breach of law and abuse of the system as a matter of public interest; regulation and supervision of all insolvency practitioners, and in future the office could also become involved in the administration of cases where the assets are insufficient to meet the costs of doing so.<sup>124</sup> While the precise functions and duties of regulatory agencies vary between jurisdictions, in broad terms their functions consistently fall within the three abovementioned categories.<sup>125</sup> Therefore, the new regulatory authority would more closely simulate other international regulators and provide services more consistent with those typically associated with that of an insolvency regulator. It is proposed that the office of the Superintendent be divided into three different sections or branches which would operate independently and be responsible for investigations and enforcement, regulation of practitioners and the administration of estates where the assets would seemingly be insufficient to cover the administration costs of the estate.

The first branch, which for now we could refer to as the "Insolvency Investigations Branch", would act as an independent enforcement unit

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120 See Calitz 2008 *Obiter* 352 for a illustration of how South African and English laws to a great extent reflect similar legal philosophies and principles.

121 Insolvency Act of 1986.

122 "Insolvency Law Reform: Promoting Trust and Confidence" *New Zealand Law Commission Study Paper 11* (2001) 33-35 (hereinafter referred to as *New Zealand Law Commission Study Paper*).

123 *Principles for effective insolvency and creditor/debtor regimes - Revised Principle D7*.

124 The so called "last resort" functions.

125 See Calitz thesis for a detailed discussion of the regulatory frameworks of the UK, US and the Netherlands.

and have responsibility for all public enforcement functions.<sup>126</sup> Prosecutions and preventions are routinely seen as the responsibility of the state in most jurisdictions; however, both activities are dependent on an adequate enquiry taking place to detect offences and abuse.<sup>127</sup> It is recommended that the Superintendent should at the initial stages of the insolvency process possess the powers to perform a basic level of enquiry and investigation into the events that lead to insolvency, whether relating to an individual debtor or the investigation of the conduct of a director or other company official. A further stage would include a reporting mechanism in matters requiring further substantive investigation or prosecution.<sup>128</sup> The facets of investigation and enforcement are once again directed at securing and assuring public confidence in the system of regulation and the process of insolvency.

The second recommended branch, which we could for now refer to as the "Insolvency Regulation Branch", would be responsible for regulating and supervising all insolvency practitioners as well as at a later stage be responsible for the regulation and appointment of Official Receivers under certain conditions.<sup>129</sup> The need for such state oversight is likely to increase exponentially where the insolvency practitioner is not appropriately qualified and does not have the necessary skills and expertise to undertake certain complex matters. But the risk, if not entirely removed, is very significantly reduced through the existence of an effective system of regulatory oversight.

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126 See s 289 Insolvency Act 1986 - Investigatory duties of Official Receiver:

"(1) Subject to subsection (5) below, it is the duty of the official receiver to investigate the conduct and affairs of every bankrupt and to make such a report (if any) to the court as he thinks fit.

(2) Where an application is made by the bankrupt under section 280 for his discharge from bankruptcy, it is the duty of the official receiver to make a report to the court with respect to the prescribed matters ; and the court shall consider that report before determining what order (if any) to make under that section.

(3) A report by the official receiver under this section shall, in any proceedings, be prima facie evidence of the facts stated in it.

(4) In subsection (1) the reference to the conduct and affairs of a bankrupt includes his conduct and affairs before the making of the order by which he was adjudged bankrupt.

(5) Where a certificate for the summary administration of the bankrupt's estate is for the time being in force, the official receiver shall carry out an investigation under subsection (1) only if he thinks fit."

127 Zhang "Developing a Regulatory Framework for Outsourcing of Insolvency Work in Hong Kong China" 193 in OECD *Asian Insolvency Systems - Closing the Implementation Gap* (2007).

128 As a division of the English Insolvency Service, the Companies Investigation Branch (CIB) investigates serious corporate abuse using compulsory powers under the Companies Act 1985.

129 In the UK the particular civil servants referred to as Official Receiver's role was brought into existence by the Bankruptcy Act 1883. Today they are civil servants who have their own legal status and act as officers of the courts to which they are appointed.

One of the key elements within a regulatory system is the symbiotic relationship between the regulatory body and the insolvency practitioner. Those who administer insolvencies – whether appointed by the creditors, by the court or by a government agency – are given functions and powers in relation to the debtor's assets under the authority of legislation: the assets and funds are not those of the practitioner, and he has a special duty to protect them. It is submitted that the nature of the appointment is seen as that of, or closely resembling, a trustee undertaking functions and exercising public interest powers for the benefit of the creditors.<sup>130</sup> But these functions and powers should thus be accompanied by responsibilities and accountabilities, and mechanisms for ensuring their proper discharge of such duties.<sup>131</sup>

In order to implement the above objectives and ensure that an individual is fit and proper to act as an insolvency practitioner, a two-pillar system is recommended. The system will depend on compulsory membership to a "Recognised Professional Body"<sup>132</sup> in addition to a mandatory licensing scheme being implemented. Firstly, in order to formally practise as an insolvency practitioner, an individual will have to obtain membership from a Recognised Professional Body and, secondly, as an additional prerequisite will also be compelled to apply successfully to the Superintendent for a formal licence to practise. The regulatory branch of the Superintendent will thus firstly be responsible for conferring on certain member organisations official "Recognised Professional Body" status, and by way of a mandatory licensing system will also have the power to directly authorise practitioners to practise as such.<sup>133</sup> The proposed system would thus represent a hybrid system of government regulation with incorporated elements of self-regulation, as opposed to the English system of self-regulation with government oversight.<sup>134</sup>

The third suggested branch of the Superintendent is the "Official Receiver's Branch", which could *inter alia* be responsible for the administration of cases as last resort where the assets in the estate are insufficient to meet the cost of administration. This function could also be extended to include cases where no private sector practitioner has

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130 Regulatory Working Group "Insolvency Law and the Regulatory Framework" 2000 at <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/LAWANDJUSTICE/GILD/O,,contentMDK:20154425~menuPK:146222~pagePK:64065425~piPK:162156~theSitePK:215006,00.html#9> (accessed 2011-07-31).

131 *Idem* 6.

132 Also referred to as RPB or Recognised Professional Body.

133 Both Australia and the UK have licensing systems for insolvency practitioners.

134 The Insolvency Act 1986 in the UK created an insolvency practitioner profession through the medium of delegated regulation. Two methods are provided: membership of and authorisation by a professional body recognised by the Secretary of State (s 391), or direct authorisation by a "competent authority" – for the time being the Secretary of State.

been appointed or cases where an urgent appointment, due to for example the nature of the assets, is required. The Superintendent will also be responsible for supervising the Official Receivers and the status of officer of court will be conferred upon each person appointed as Official Receiver.<sup>135</sup> Apart from this status in relation to which an Official Receiver would exercise its functions, the Superintendent would also be responsible for setting down certain criteria in regard to qualifications and experience in order for a person to be appointed as an Official Receiver.

The branch of Official Receivers could also be utilised as a training facility not only for government officials but also to provide technical insolvency training for insolvency practitioners. A scheme where it would be possible for practitioners to register as trainees at the branch of the Official Receivers could not only assist practitioners in obtaining practical experience but could also make a positive contribution to the resources of such office. It is submitted that the involvement of the branch of the Official Receiver in the administration of estates could gradually be phased in as part of the overall regulatory structure. This outcome would not only allow for sufficient training of individuals in this specific field of law, but also ensure that the structure and functions of this office are adequately thought through in order to be integrated successfully into the general regulatory scheme.

### **4 3 Complaints Mechanism**

From the outset of this study it has been made clear that one of the key considerations when making recommendations regarding law reform would have to be that of public interest within the spirit of the Constitution. In order to develop a system based on accountability, which would satisfy the public interest and create trust and confidence in the system, it would be vital that key factors such as the independence of the Superintendent, the mechanisms of accountability for the insolvency practitioners and public servants as well as the procedures to receive and investigate complaints are put in place.

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<sup>135</sup> See discussion of concept of "officer of the court" in Calitz thesis part VI. See also s 400 Insolvency Act 1986 – functions and status of official receivers:

"(1) In addition to any functions conferred on him by this Act, a person holding the office of official receiver shall carry out such other functions as may from time to time be conferred on him by the Secretary of State.

(2) In the exercise of the functions of his office a person holding the office of official receiver shall act under the general directions of the Secretary of State and shall also be an officer of the court in relation to which he exercises those functions.

(3) Any property vested in his official capacity in a person holding the office of official receiver shall, on his dying, ceasing to hold office or being otherwise succeeded in relation to the bankruptcy or winding up in question by another official receiver, vest in his successor without any conveyance, assignment or transfer."

It is submitted that the Superintendent should have a complaints mechanism in place, to be able to act as a conduit through which complaints could be channelled to the respective Registered Professional Bodies, and in some cases the complaints could also be subject to an investigation by the Superintendent itself. The Registered Professional Bodies would be required to have a formal complaints procedure to ensure that these procedures are harmonised throughout the spectrum. The policy aim would be to have a disciplinary procedure in place that is just and fair to all parties concerned, including the practitioner and the complainant, and that is transparent. Doing so will create trust and confidence in the insolvency system.<sup>136</sup>

Apart from the internal structures, it is submitted that an "Insolvency Tribunal" should be established. It is submitted that the Tribunal should be an independent judicial body, subject only to the Constitution and the law, so as to ensure that it functions impartially and without fear of favour or prejudice. The Tribunal could function in a similar way to the Companies Tribunal,<sup>137</sup> and as an organ of state have a dual mandate:

- (a) to serve as a forum for the adjudication of disputes as well as voluntary alternative dispute resolution in any matter arising from the Insolvency Act
- (b) to carry out reviews of administrative decisions made by the Superintendent on an optional basis.<sup>138</sup>

The High Court would however remain the primary forum for the resolution of disputes, and for the interpretation and enforcement of the proposed Insolvency Act.

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<sup>136</sup> See s 287 Insolvency Act 1986 - Action of Tribunal on reference:

"(1) On a reference under section 396 the Tribunal shall -

(a) investigate the case, and

(b) make a report to the competent authority stating what would in their opinion be the appropriate decision in the matter and the reasons for that opinion, and it is the duty of the competent authority to decide the matter accordingly.

(2) The Tribunal shall send a copy of the report to the applicant or, as the case may be, the holder of the authorisation; and the competent authority shall serve him with a written notice of the decision made by it in accordance with the report.

(3) The competent authority may, if he thinks fit, publish the report of the Tribunal."

<sup>137</sup> See s 195 Companies Act, 2008.

"The Companies Tribunal or a member of the Tribunal acting alone in accordance with this Act, may -

(a) adjudicate in relation to any application that may be made to it in terms of this Act, and make any order provided for in this Act in respect of such an application;

(b) assist in the resolution of disputes as contemplated in part C of chapter 7; and

(c) perform any other function assigned to it by or in terms of this Act, or any law mentioned in Schedule 4."

## 5 Concluding Remarks

While there have been many efforts to reform and modernise the South African insolvency system, the process has always lacked political clout. With the current rise in insolvencies and liquidations, the importance of substantial reform efforts to establish an effective insolvency culture and legal practice should be recognised. Such a system will distribute, re-distribute, or use assets from a failed business or insolvent individual more efficiently, effectively and fairly through the insolvency process. The role of policy- and lawmakers will therefore play a major part in reforming South African insolvency law in general as well as in determining policy and developing an appropriate regulatory regime for insolvency law.

The recommendations made here will involve a paradigm shift in the perceptions of the public as well as other role-players and will require a reorientation towards all aspects of regulation in insolvency law. As previously submitted, it would be possible to attempt to weave the proposed recommendations into the present suggestions made by the Commission. This option would however not only represent a superficial approach to the reform of our regulatory regime, but will also prove to be problematic with regard to the implementation of some of the most critical aspects of the proposed regime, namely the introduction of an independent and complete regulator with functions consistent with global norms and international standards.<sup>139</sup>

It is thus generally concluded that South African law- and policymakers should return to the drawing board and engage in further research and consultation in order to incorporate a modern and sophisticated regulatory framework into our insolvency law. There is a pressing need to introduce a regulatory model that would not only be consistent with global norms but that can also be adapted to the particularity of our national situation. This bold approach will require not only the political will and support of national policymakers, but also the technical assistance of international financial institutions and aid agencies of

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138 See s 6 Promotion of Administrative Justice Act 3 of 2000 (PAJA). Before someone can ask a court to review an administrative action, there is an important rule in the PAJA that must be complied with – the rule of exhaustion of internal remedies. This means that, where the law sets out procedures allowing someone to review or appeal a decision of the administration, these must be pursued before an affected person can approach a court. A person can therefore only ask for judicial review as a last resort. This is dealt with in s 7(2) PAJA. Internal remedies are ways of correcting, reviewing or appealing administrative decisions using the administration itself. The difference between internal remedies and the remedy of judicial review is that the judicial review is review by a court, which is independent from the administration. See Calitz thesis part IV for a detailed discussion of the administrative law aspects of state regulation in South African insolvency law.

139 See Calitz thesis part VII for further recommendations.

advanced economies.<sup>140</sup> Although this option will represent a costly exercise, commercial and consumer insolvencies have become too important phenomena legally as well as socially and economically to be shortchanged with nominal budgets.<sup>141</sup>

If the aim of any law reform proposal is to build an effective and efficient insolvency system and regulatory framework, then the development of a strong administrative component will have to be a priority. The reality of overburdened judicial services cannot be ignored, and as a result it would make sense to develop a regulatory system that is as independent from the court structure as possible. South African law- and policymakers are at present on the threshold of introducing significant new legislation into insolvency law. Interested parties will have to achieve a balance between the interests of debtors and creditors and the public interest while at the same time acknowledging the link between these interests and institutional structures and their capacities. The absence of an effective insolvency regime will have an adverse impact on the future availability of credit and foreign capital.<sup>142</sup> The design and development of a strong central government agency responsible for regulating South African insolvency law has therefore become vital in assuring public confidence in the system of regulation and supervision, and in the process of insolvency law.<sup>143</sup>

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140 Halliday 34.

141 Ziegel "Bill-55 and Canada's Insolvency law Reform Process" 2006 *Canadian Business* LJ76.

142 See Falke *Insolvency Law Reform in Transition Economies* (LLD thesis 2005 Humboldt University) 27.

143 Cf Mistelis 1057.