SECTIONS 417 AND 418 OF THE COMPANIES ACT 61 OF 1973 – RELEVANCE PREVAILING OVER THE RIGHT TO PRIVACY

Gumede v Subel NO 2006 3 SA 498 (SCA)

1 Introduction

"Though this be madness, yet there is method in't."
Hamlet quote (Act II, Scene II)

As the bulk of the law of insolvency is procedural it is by nature a rights-based law, for the rules of procedure are premised on the principles of the law of natural justice. Bankruptcy laws have traditionally been procedural statutes providing a means by which a debtor and all his or her creditors may readjust their relationship when the debtor becomes insolvent (*cf* Plank "The Constitutional Limits of Bankruptcy" 1996 *Tennessee Law Review* 487 495).

In *Gumede v Subel NO* (2006 3 SA 498 (SCA)) the issue the Supreme Court of Appeal had to decide was whether the right to privacy entrenched in section 14 of the Constitution of the Republic of South Africa Act, 1996 (hereinafter "the Constitution") entitled the appellants to refuse to produce documents as summoned by the commissioner in an enquiry in terms of section 417 read with section 418 of the Companies Act (61 of 1973) (unless otherwise stated, all references to sections are references to this Act). Before discussing and commenting on the decision in *Gumede* it is necessary to first provide a brief summary of the facts and judgment of the case.

2 Facts and judgment

The first respondent, a member of the Johannesburg Bar, was appointed by the Master of the High Court (hereinafter "the Master") as a commissioner in an enquiry in terms of section 417 read with section 418 of the Act into the affairs of an insolvent company, Acquired Card Technologies (Pty) Ltd (in liquidation) (hereinafter "the ACT"). During the course of the enquiry the commissioner ordered Mr Gumede, the first appellant and executive director of the Gijima Group, and the Gijima Group itself, to produce certain documents relating to the business affairs of ACT. The documents related to a tender by ACT to Telkom for the manufacturing of phone cards which formed the main business of ACT. Subsequently the tender was awarded to a company in the Gijima Group (as opposed to ACT), thereby raising the question of a possible diversion of a corporate opportunity by the executive director and the Gijima Group. The appellants objected to the disclosure of

the documents on the basis that they were confidential. The commissioner dismissed the objection and found that "in my view it would be sufficient if I believe on reasonable grounds that the documents… are relevant to the trade, dealings, affairs or property of ACT" (par [11] 503E/F).

This was followed by review proceedings in the court *a quo*, and the appeal against such ruling. The main issue for determination on appeal was if in the case of an enquiry into the conduct of an insolvent company, relevance prevails over the right to privacy in terms of section 14 of the Constitution.

The court rejected the argument that once a constitutional right is in issue, the person wishing to infringe the right must show "sufficient cause" why that should be done (par [19] 505H/I). It held that the proper approach is to determine whether or not there is reason to believe that the documents in question would throw light on the affairs of the company before the winding-up. If so, the relevance of the material will generally outweigh the right to privacy (par [19] 505H/I). The court also agreed with Du Toit AJ in the court *a quo* that "the interest in the proper administration of the winding-up and the protection of creditors…outweigh any claim to privacy in the circumstances of this particular case" (par [21] 507A). The decision of the Johannesburg High Court, refusing to set aside the ruling on review, was upheld (par [25-27] 508B/D).

3 Enquiries in terms of section 417 read with section 418 of the Companies Act

Section 417 of the Act provides for a private enquiry into the trade, dealings, affairs or property of an insolvent company unable to pay its debts (at the time it is sought to invoke the section, *cf Hudson v The Master* (2002 1 SA 862 (T) 868-869), and which company has been wound up by the court (*cf Janse Van Rensburg v The Master* (2001 3 SA 519 (W)).

At any time after a winding-up order has been made, including a provisional winding-up order, the court or the Master may summon –

> "[A]ny director or officer of the company or person known or suspected to have in his possession any property of the company or believed to be indebted to the company, or any person whom the Master or the Court deems capable of giving information concerning the trade, dealings, affairs or property of the company" (s 417(1)).

The Master or the court may also require –

> "[A]ny such person to produce any books or papers in his custody or under his control relating to the company but without prejudice to any lien claimed with regard to any such books or papers, and the Court shall have power to determine all questions relating to any such lien" (s 417(3)).

Section 418 of the Act empowers the Master to delegate its powers under section 417 to a commissioner who would typically be a senior magistrate, advocate or attorney with experience in this field of law. This would usually be the case where urgency prevails. Because of the probability that assets

may be removed or evidence be destroyed, it might at times be essential for the liquidator to convene an enquiry without delay. If the Master is not readily available to preside at such enquiry it is advisable to apply for an enquiry in terms of section 417 read with section 418 to be held before a commissioner who could be available at short notice.

In the case of *Receiver of Revenue, Port Elizabeth v Jeeva* (1996 2 SA 573 (AD)) the court set out the role of the commissioner as –

> "[T]he person who conducts the enquiry. It is he who has to act in a quasi-judicial capacity. He has the main duty to examine the witnesses. He has to regulate and control the interrogation. Should he fail in his duty to apply the procedural fairness appropriate to this forum, an aggrieved party may approach the court for suitable relief (579H)" (*cf* Meskin *Insolvency Law and Its Operation in Winding-up* Butterworths loose-leaf ed par 8.5.2).

One of the most important responsibilities of a liquidator appointed to administer the estate of an insolvent company is to extend the asset pool available for distribution to the creditors of the company, so as to ensure that the creditors receive as large a return as possible. One of the mechanisms used by the liquidator to gather information and seek assets is to convene an enquiry into the business and affairs of the insolvent company.

In practice the application for an enquiry to the court or the Master is mostly made by the liquidator, as being best situated to know why the effective administration of the winding-up necessitates there being an examination or enquiry. In the case of *Lok v Venter NO* (1982 1 SA 53 (W)) the court held, however, that a person approaching the court need not have any financial or other interests in the company concerned. Section 417 gives the court the power to summons before it persons believed to be capable of giving information concerning the trade, dealings, affairs or property of the company, and gives the court the power to examine such persons under oath (58A).

4 Right to privacy

Section 14 of the Constitution as part of the Bill of Rights (Chapter 2) reads as follows: "Everyone has the right to privacy, which includes the right not to have – their person or home searched; their property searched; their possessions seized; or the privacy of their communications infringed." The section consists of two parts, the first part protecting the right to privacy and the second deals with specific infringements, namely seizures, searches and privacy of communications.

The test to establish if there has been an unlawful infringement of privacy is twofold and the following questions need to be answered: (a) Has the invasive law or conduct infringed the right to privacy in the constitution? (b) If so, is such an infringement justifiable in terms of the requirements of the limitation clause of the Constitution (s 36(1))?

Section 36 provides that the rights entrenched in the Bill of Rights may be limited only in terms of law of general application to the extent that the

limitation is reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom. All relevant factors should be taken into account, including the nature of the right; the importance of the purpose of the limitation; the nature and extent of the limitation; the relation between the limitation and its purpose; and less restrictive means to achieve the purpose (for a discussion of the limitations of rights and s 36 as a general limitation clause refer to Rautenbach *et al Constitutional Law* 4ed (2004) 315).

In *Bernstein v Bester NNO* (1996 2 SA 751 (CC)) privacy has been described as "an amorphous and elusive" concept. Ackermann J held that privacy should be demarcated with respect to the rights of others and the interests of the community (De Waal *et al The Bill of Rights Handbook* 5ed (2005) 315-322). The court pointed out that it was difficult to see how information regarding the affairs of an insolvent company which an individual possesses can be private (par [83] 796B). Even if confidential facts were included in the summoned documents, the compulsion to disclose may amount to a justifiable limitation of privacy (De Waal *et al* 319).

5 Effect of insolvency on the right to privacy

The constitutionality of the provisions of section 417 has been upheld by the Constitutional Court (*cf Bernstein v Bester (supra*)), with the exception of the provision in section 417(2)(b) that "any answer given to any such question may thereafter be used in evidence against him" (par [60] 786B/G). This latter provision has been held to be constitutionally invalid in relation only to criminal proceedings against the person concerned, except where the relevant charges relate to the giving of perjured evidence or a failure to answer lawful questions fully and satisfactorily (*cf Ferreira v Levin NO* (1996 1 SA 984 (CC)).

When ruling on the constitutionality of section 417 proceedings the central reasoning of the court in *Bernstein* (*supra*) was that the provisions under attack did not compel the commissioner to infringe on the fundamental rights of the individuals and a proper remedy was available in the form of a review action in the Supreme Court. It was therefore possible to "read down" the statutory provision in terms of section 35 (Interim Constitution) and it could be utilised by the Supreme Court to avoid infringement of any of the fundamental rights (par [60] 786A/H) (*cf* De Waal *et al* 65). In *Mistry v Interim Medical and Dental Council of South Africa* (1998 4 SA 1127 (CC)) the court emphasized that "the more public the undertaking and the more closely regulated the more attenuated the right to privacy would be and the less intense any possible invasion" (1129H).

In the *Bernstein* case (*supra*) the court confirmed that the mechanisms embodied in section 417 further very important public policy objects, such as the honest conduct of the affairs of a company (par [50] 782A). The majority of the court expressed the opinion that the information sought at such an enquiry pertained to "participation in a public sphere" and could not rightly be held to be "inhering in the person" (par [84] 796F). The court also held that

the benefits of limited liability bring with them corresponding obligations of disclosure and accountability and that nothing in the challenged provisions was according to the majority of the court inconsistent with procedural fairness. There was thus no reasonable expectation of privacy (Meskin par 8.5.2). (Ss 415 and 417 of the Companies Act 61 of 1973 have now been amended by s 10 of the Judicial Matters Amendment Act 55 of 2002 as published in *GG* 24277 of 17 January 2003. After the amendment of section 417(2)(b) a witness cannot refuse to answer a question that might incriminate him, but if he does refuse on such ground, the Master or court, after consulting with the Director of Public Prosecutions who has jurisdiction, can compel the witness to answer the question.)

6 Other jurisdictions

The United Kingdom has a similar provision to our section 417 in section 236 of the Insolvency Act of 1986 (hereinafter "the Insolvency Act") which states that:

> "The court may, on the application of the office-holder, summon to appear before it – (a) any officer of the company, (b) any person known or suspected to have in his possession any property of the company or supposed to be indebted to the company, or (c) any person whom the court thinks capable of giving information concerning the promotion, formation, business, dealing, affairs or property of the company."

Section 236 of the Insolvency Act grants the court, at the instigation of an office holder, the power to conduct a searching examination of witnesses with a view to obtaining information regarding the company. It also enables the court to compel the production of relevant documents, which may be critical to the potential application of the Insolvency Act remedies.

Australian insolvency legislation also makes provision for a private enquiry into the affairs of a company that is being wound-up. The Corporations Act 2001 (hereinafter "the Corporations Act") allows for the court to summon a person for examination regarding a corporation's examinable affairs and may require the person to produce at the examination specified books that are in the person's possession; and that relate to the corporation or to any of its examinable affairs (s 596A). Section 597 of the Corporations Act states that an examination is to be held in public except to such extent as the court considers that, by reason of special circumstances, it is desirable to hold the examination in private.

The court may also issue a direction that a person be excluded from an examination, even while it is being held in public, and issue a direction prohibiting publication or communication of information about the examination and that a document that relates to the examination and was created at the examination be destroyed (ss 596F and 597 of the Corporations Act).

7 "Private and confidential"

Unless the court or, as the case may be, the Master, were to direct otherwise, section 417(7) operates to deny all persons access to the application and any documents accompanying it and to the examination or enquiry itself, the record of it, and to any books or papers produced at it (*cf* Meskin *Henochsberg on the Companies Act* (1994 – Service Issue) 894(6) and see *Cordiant Trading CC v Daimler Chrysler Financial Services (Pty) Ltd* (2005 4 SA 389 (D)). In *Merchant Shippers SA v Millman* (1986 1 SA 413 (C)) the court stated that there was good reason for the preservation of secrecy, not only with regard to the examination, but also the application for the enquiry. The judge emphasized that the reason for the enquiry was to enable the liquidator to seek assets to the advantage of creditors. If the information regarding the application and the matters which were to be inquired were to be made public it would complicate the task of the liquidator considerably (414G-H).

When ascertaining the truth surrounding the collapse of the insolvent company the right to privacy of the individual witness would be weighed up against the public's interest when ruling whether the witness would be summoned to testify or produce books or records at the proceedings. Especially in a liquidation of considerable size and complexity, there are almost certain to be many transactions which are difficult to discover or to understand merely from the books and papers of the company. Accordingly, the legislature has provided this extraordinary and secret process so as to assist the liquidator to obtain the necessary information for the proper conduct of the winding-up.

8 Conclusion

Insolvency of big international enterprises such as Enron and Parmalat and more recently the JCI/Randgold-debacle in South Africa, has awakened public interest in insolvency law and proceedings. Enquiries in insolvent estates have become newsworthy items and are more frequently moving into the public domain by way of media coverage.

There have been several outcries by the media for the abolishment of the so-called "private and confidential" provision. As one of the leading newspapers comments:

> "As the corporate world is forced to become increasingly transparent and the constitutional spirit becomes more entrenched, the Master will be called on more frequently in terms of section 417(7), wasting his time as well as that of the commissioner, the liquidator and possibly the courts in circumstances in which there is no reason for survival of this antiquated provision" (Hamburger *Mail & Guardian online* (2002-11-18) found at *http://www.themedia.co.za*).

The judgment in the *Gumede* case (*supra*) follows the Constitutional Court's approach that the plight of the insolvent company's creditors must as a general rule prevail over a claim of privacy under the Constitution. The judgment is also in line with international notions when dealing with

insolvency and the right to privacy. It is also submitted that during a private enquiry the examinees are not in any ordinary sense witnesses, and the ordinary standards of procedure do not apply (*cf Re Rolls Razor Ltd Re Rolls Razor Ltd* (1969 3 All ER 1386)). As the evidence furnished at such proceedings has thus not been tested, it is essential for the Master or the court to exercise control over the publication of such information.

It is mainly the key function of the liquidator to quantify and preserve assets of an insolvent company that necessitates extraordinary powers of investigation. Although certain provisions for the insolvent or office bearers of a company to co-operate and provide information have been included in insolvency legislation, the obligation to co-operate does not have the same dramatic and forceful effect as a cross-examination under oath. The nature of the private enquiry has been summarized by the comment of Megarry J In *Re Rolls Razor Ltd Re Rolls Razor Ltd* (*supra*) that:

> "The process … is needed because of the difficulty in which the liquidator in an insolvent company is necessarily placed … He usually comes as a stranger to the affairs of the company which has sunk to its financial doom…Accordingly the legislature has provided this extraordinary process so as to enable the requisite information to be obtained" (1396H-I).

In the *Gumede* case (*supra*) the purpose of section 417 proceedings was again recognized as the acquisition of information and the recovering of assets to the benefit of creditors (par [21] 506F). It is submitted that apart from financial loss, white collar crime also affects the attractiveness of a country as an investment destination for international investors. The provisions under sections 417 and 418 represent at least one of the measures available to curb fraud and corruption as a phenomenon in our society.

The judgment by the Supreme Court of Appeal in the *Gumede* case (*supra*) contributes to the considerable body of case law available on private enquiries in terms of sections 417 and 418 of the Companies Act. The judgment gives emphasis to the remark by Ackermann J in *Bernstein v Bester (supra*) that "[t]he constitutionality of sections 417 and 418 must therefore be assessed in the light of the control which the Supreme Court exercises over their implementation".

Juanitta Calitz
University of Johannesburg