



**DEPARTMENT OF MERCANTILE LAW
MODULE: INSOLVENCY LAW
MODULE CODE: MRL3701 (MRL301M)**

Contents

Only Study Guide for MRL3701 (MRL301M)

The purpose of this Study Guide is to lead you through the prescribed textbook and the prescribed cases.

USE THIS STUDY GUIDE with Sharrock et al *Hockly's Insolvency Law* 8 ed (2006), the current version of the prescribed textbook for this module.

CONTENTS

INSOLVENCY LAW – MRL3701 (MRL301M)

OVERVIEW..... 1

INTRODUCTION TO THE MODULE..... 7

Study unit 1

 INTRODUCTION TO INSOLVENCY LAW 11

 The scenario involving Tenza 12

Study unit 2

 VOLUNTARY SURRENDER 20

Study unit 3

 VOLUNTARY SURRENDER 26

Study unit 4

 COMPULSORY SEQUESTRATION 36

Study unit 5

 COMPULSORY SEQUESTRATION 48

Study unit 6

 THE LEGAL POSITION OF THE INSOLVENT 57

Study unit 7

 VESTING OF THE ASSETS OF THE INSOLVENT 67

Study unit 8

 VESTING OF THE ASSETS OF THE SOLVENT SPOUSE 75

Study unit 9

 UNCOMPLETED CONTRACTS AND LEGAL PROCEEDINGS NOT YET FINALISED
 81

Study unit 10

UNCOMPLETED CONTRACTS AND LEGAL PROCEEDINGS NOT YET FINALISED	93
---	----

Study unit 11

UNCOMPLETED CONTRACTS AND LEGAL PROCEEDINGS NOT YET FINALISED	101
---	-----

Study unit 12

MEETINGS OF CREDITORS AND PROOF OF CLAIMS	108
---	-----

Study unit 13

THE ELECTION OF THE TRUSTEE	113
-----------------------------------	-----

Study unit 14

IMPEACHABLE DISPOSITIONS — INTRODUCTION, AND DISPOSITIONS MADE NOT FOR VALUE	121
--	-----

Study unit 15

VOIDABLE DISPOSITIONS — VOIDABLE AND UNDUE PREFERENCE, COLLUSIVE DEALINGS AND THE <i>ACTIO PAULIANA</i>	133
---	-----

Study unit 16

IMPEACHABLE DISPOSITIONS — TRANSFER OF BUSINESS WITHOUT PRESCRIBED NOTICE	145
---	-----

Study unit 17

CREDITORS' CLAIMS AND THEIR RANKING — THE DIFFERENT TYPES OF CREDITORS	151
--	-----

Study unit 18

CREDITORS' CLAIMS AND THEIR RANKING — THE ORDER OF RANKING FOR PAYMENT	162
--	-----

Study unit 19

COMPOSITION	171
-------------------	-----

Study unit 20

REHABILITATION..... 177

Study unit 21

PARTNERSHIP AND SEQUESTRATION..... 183

Study unit 22

WINDING-UP OF COMPANIES 191

Study unit 23

JUDICIAL MANAGEMENT AND COMPROMISE 202

Study unit 24

WINDING-UP OF CLOSE CORPORATIONS 207

INSOLVENCY LAW – MRL3701 (MRL301M) OVERVIEW

Dear Student

Welcome to this module on Insolvency Law (the code for which is MRL3701).

1 The purpose of this module

This module, Insolvency Law (MRL3701), is a third-level module dealing with the law of insolvency (voluntary surrender and compulsory sequestration), and with the liquidation (winding-up) and the judicial management of companies.

This module is a compulsory module for the LLB degree at Unisa.

2 Learning about Insolvency Law

2.1 Why should you as a learner know or learn about Insolvency Law?

It is a fact of life that people do become insolvent. They become insolvent when they are so overburdened by debt that their debts (what they owe to other persons) are worth more than their property (what they own). Insolvency (which in English law and American law is also called bankruptcy) may sometimes come about through misfortune, and be no fault of the debtor. On the other hand, though, some debtors cannot manage their financial affairs well, and spend more than they own; easy credit in the shops may often tempt them to live beyond their means. Insolvency law provides a procedure for dealing fairly with the claims that the unpaid creditors of the insolvent person have against the insolvent estate. Insolvency law also protects the debtor from being harassed by his or her creditors.

Similarly, juristic persons such as companies may also fall on hard times. In the separate module on Entrepreneurial Law (code MRL203L), you will study the “life” of companies. In this present module on Insolvency Law (MRL3701), however, you will study the “disease” and “death” of companies and close corporations.

2.2 Important issues in this module

To gain an idea of the important issues that you will study in this module on Insolvency Law, it may be convenient for us briefly to describe the process of insolvency and winding-up for you. There is a procedure by which the debtor that is in financial trouble, or the creditors of that debtor, may apply to the High Court to obtain an order that will place the debtor in sequestration or winding-up. Once the relevant court order has been granted the effect of sequestration or winding-up on the debtor, both as regards status and capacity and as regards control of the debtor’s property, is significant. The effects of the sequestration of the estate of a natural person (a human being) even extend to the spouse of the insolvent debtor.

A **trustee** is appointed to administer the **insolvent estate**; a **liquidator** is appointed to administer the **company or the close corporation being wound up**. This appointee, who is voted for by the creditors at the relevant meeting of creditors of the debtor, must then take control of the insolvent estate or the company, and collect all the property of the debtor

(including debts owed to the debtor by other persons) that lawfully forms part of the insolvent estate. Special provisions enable the trustee or the liquidator to challenge suspect transactions (called impeachable dispositions) entered into by the debtor before sequestration or winding-up. By relying on such provisions the trustee or the liquidator may expand the assets that will have to be sold in order to pay the claims of creditors of the debtor in the appropriate order of preference.

After the insolvent natural person has met the prescribed requirements he or she may apply to the High Court for rehabilitation. A rehabilitation order ends the period of sequestration, and the previously insolvent person may then conduct business and take part in society without the disabilities flowing from being an insolvent under sequestration.

By contrast, when the winding-up (also called the liquidation) of the company or the close corporation has been completed the juristic person is dissolved and its existence comes to an end. It is then a “dead” company or close corporation.

Sometimes, however, the debtor need not go through the whole process of sequestration or winding-up. A natural person (a human being) may be able to enter into a compromise (or composition) with his or her creditors, by which the creditors agree to accept a partial payment of their claims. If the partial payment is more than half the value of certain claims the debtor may then apply immediately to the High Court for his or her rehabilitation. Similarly, it may be possible to rescue juristic persons without their having to be wound up; to speak in picturesque terms, these companies or close corporations may be regarded as “diseased”, rather than “dead”. Contracts of compromise may thus also be entered into by companies and close corporations with their creditors. And for companies only, there is a further alternative route – though in practice seldom a successful one – called judicial management. A judicial manager is appointed to take control of the company and try to correct the problems of mismanagement that prevent the company from being or becoming a successful enterprise.

So the important issues in this module on Insolvency Law (MRL3701) will include the following:

- obtaining a sequestration order
- voluntary surrender of the estate by the debtor
- compulsory sequestration of the estate on the application of the creditors
- the legal position of the insolvent
- vesting of the assets of the insolvent
- vesting of the assets of the solvent spouse
- uncompleted contracts
- meetings of creditors
- the election of the trustee
- impeachable dispositions
- creditors’ claims and their ranking
- composition
- rehabilitation
- partnership and sequestration
- winding-up of companies
- judicial management and compromise
- winding-up of close corporations

3 Learning outcomes of this module

You will notice that we have included learning outcomes for each study unit. The learning outcomes at the beginning of each study unit indicate what competence you should be able to demonstrate at the end of this learning experience. We expect you to achieve the learning outcomes. If you work through the learning material by following the guidance and doing the activities in this Study Guide, you should be able to achieve the learning outcomes.

You will also find an application learning outcome. This will always be the last outcome in each unit. This learning outcome is a standard feature that will remind you that you need to be able to apply your knowledge in order to carry out the activities and to answer the self-test questions such as those in the particular study unit.

4 The learning-material package

The Unisa learning-material package consists of:

4.1 A wrap-around Study Guide

The purpose of this Study Guide is to lead you through the prescribed textbook and the prescribed cases.

4.2 Tutorial Letter 101

The purpose of Tutorial Letter 101 is to give you information on how to contact the University, how to answer assignments, which questions to answer in your voluntary assignment, and how to answer problem-type questions.

You will have to buy the following two books:

- **A textbook:** Sharrock R, Van der Linde K & Smith A, *Hockly's Insolvency Law*, 8th edition (2006), Juta, Lansdowne.
- **A case book:** Loubser A, *Case Book on the Law of Partnership, Company Law and Insolvency Law* (1992), Juta, Kenwyn.

You will find more information about these books in Tutorial Letter 101.

In addition to Tutorial Letter 101 and this Study Guide you will also receive Tutorial Letter 201 during the semester. Tutorial Letter 201 will contain the following:

- suggested answers to the assignments (both the assignment that you will submit for us to mark, and the one that you will mark yourself at home)
- a copy of a previous examination paper together with the suggested answers to it
- advice on preparing for the examination that you will sit

5 The learning process

We should like to support you in your learning process. We can support you, however, only if you take responsibility for your own learning. So you have to work through the tutorial letters and the learning material and plan a schedule for your learning process to ensure that you submit all the assignments and prepare for the examinations in time. We suggest that you follow the following steps in your learning process:

Step 1: Work through the overview in this Study Guide and Tutorial Letter 101. This step will provide all the important information that you need to complete the learning process successfully.

Step 2: Start working through the study units in this Study Guide. Study the relevant chapters and cases in the textbook and case book. The readings that you have to study for each study unit are indicated in a box. For example, in study unit 1 you will find the following box:

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly 1.1 up to and including 1.6, and 1.7.3.

Omit Hockly 1.7.1. up to and including 1.7.2.

Also study the following:

Magnum Financial Holdings (Pty) Ltd (in Liquidation) v Summerly and another NNO 1984 (1) SA 160 (W) (case[28] in Loubser)

Do all the activities in this Study Guide.

Step 3: Complete and submit the relevant assignments.

Step 4: Prepare for the examination by revising the study units in this Study Guide and the activities. Study all the tutorial letters that you receive during the year.

In study unit 1 of this Study Guide, you will be introduced to Tenza (see the heading entitled “The scenario involving Tenza”). In each study unit, we shall add information about Tenza’s insolvency status to relate to the issues discussed in each study unit. You will note that we also refer to Tenza’s case study in the text and in the activities, thus helping you understand the practical implications of the different issues in Insolvency Law.

Glossary/Word power: We have included a glossary/word power in the study unit entitled “Introduction to the module”. This list of words consists mostly of Latin words and phrases and their translations into English.

6 The assessment strategy

The assessment strategy for this module consists of the following:

6.1 Activities in this Study Guide

Complete these activities, to ensure that you understand the new work and can apply the new knowledge to real cases or scenarios. These activities should also assist you to achieve the learning outcomes. We provide feedback on each of these activities at the end of each activity.

6.2 Self-test questions

As the name “self-test questions” indicates, the purpose of these questions at the end of every study unit is to test how well you understand what you have studied in the prescribed textbook (Hockly), the prescribed cases, the commentary in the study unit, and the activities concerning the study material. We encourage you to try to answer the self-test questions without looking at the answers that we suggest for the questions, and also to answer these questions several times throughout the semester without looking at your textbook, cases, Study Guide, or notes. In this way, you will give yourself practice in preparing to sit the examination without the aid of your textbook, cases, Study Guide, or notes.

6.2.1 True-or-false questions

You will notice that each set of self-test questions includes one true-or-false question. You will also be answering 13 true-or-false questions in question 2 of the examination paper at the end of the semester. In case you are not familiar with answering true-or-false questions, we now give the following guidance on how to deal with this type of question:

- You will be asked to indicate whether a statement is true or false by answering “True” or “False” without any further explanation. Do not therefore give any further explanation.
- The questions (like the others in the examination paper) will cover the whole of the material prescribed for this module. Do not therefore be tempted to leave out any prescribed material in the hopes that we shall not ask questions on it.
- Read each statement through several times before you write your answer. You only have to write “True” or “False”, so spend your time wisely on planning your answer.
- Pay special attention to words such as “not”, “usually”, “generally”, “only”, and “the general rule”.
- If a statement consists of two or more parts, remember that for such a statement to be true, both or all its parts have to be true. If only one of the parts of such a

statement is false, the whole statement must be false. For example, consider the following statement: “Compulsory sequestration is the procedure by which a creditor must apply to have the debtor’s estate sequestered, and among the requirements that the creditor has to prove is that sequestration will be to the advantage of creditors”. Now the first part of this statement – “Compulsory sequestration is the procedure by which a creditor must apply to have the debtor’s estate sequestered” – is true. (See the introduction to Hockly ch 3.) The second part of the statement, however, is false. Examine its wording: “among the requirements that the creditor will have to prove is that sequestration will be to the advantage of creditors”. The relevant requirement for compulsory sequestration, however, is that “there is reason to believe that it will be to the advantage of creditors of the debtor if his estate is sequestered” (see Hockly 3.1, third bulleted item in the list). The words “**there is reason to believe that it will be to the advantage of creditors**” differ from the words “sequestration will be to the advantage of creditors”. See the discussion of this difference of wording in Hockly 2.2.3, and also the discussion of *Meskin & Co v Friedman* 1948 (2) SA 555 (W) at 558, and also in Hockly 3.1.3. Because this second part of the statement under consideration is false, the whole statement is false.

6.3 The five-minute paper

You will find a five-minute paper at the end of each study unit. The purpose of this activity is to give you an opportunity to think about your own learning and the successes and challenges you are experiencing in a specific study unit. Answering the five-minute paper is also intended to help you pace your study sessions, so that you break up your studying into manageable portions rather than trying to rush through large stretches of material. Rushing through large stretches of material carries with it the danger that you may have difficulty remembering the finer details of the study material, and that you may muddle rules and principles that apply to different situations.

6.4 Assignments – submission and self-assessment

Refer to section 6 in Tutorial Letter 101 for further information about the assignments. This section sets out the **compulsory assignment that you must submit to us for marking by a certain date**, and the voluntary assignment that you will answer and mark yourselves with the aid of the suggested answers that we shall send you in Tutorial Letter 201 during the semester.

6.5 Examination

Refer to section 5 in Tutorial Letter 101 for further information about the examination.

We are looking forward to supporting you on your learning journey. We also thank Ms Mpho Tshesane and Ms Jean Grundling of the Bureau for Learning Development at Unisa for helping us revise the study material of this Study Guide.

Good luck!

**THE LECTURERS
UNISA**

INTRODUCTION TO THE MODULE

This Study Guide and its use

The prescribed book which you must use for MRL3701 is *Hockly's Insolvency Law*, 8th edition (2006), Juta, Lansdowne, by Robert Sharrock, Kathleen van der Linde, and Alastair Smith.

By means of this Study Guide for MRL3701 we wish to lead you through the textbook. We shall point out some points to note in particular, give some examples, and try to clear up possible obscurities. The study units of this Study Guide bear the same titles as the chapters of the textbook, although some chapters of the textbook are divided into more than one study unit. All paragraph references in this Study Guide are to the relevant sections in Hockly, unless otherwise indicated.

We wish to emphasise that you do not need to study the whole textbook. In a box at the beginning of each study unit we shall tell you which sections to study for the assignments and the examination, and which sections to omit. Although we shall not comment in this Study Guide on each prescribed section of every chapter in Hockly, you should still study what we require you to study. THE SECTIONS THAT YOU SHOULD OMIT WILL NOT BE TESTED EITHER IN THE ASSIGNMENTS OR IN THE EXAMINATION.

Prescribed cases

In Tutorial Letter 101, a few of the important decisions by the courts on insolvency and winding-up will be prescribed. **STUDY THESE JUDGMENTS.** Shortened versions of these prescribed cases are included in the book *Case Book on the Law of Partnership, Company Law and Insolvency Law* (1992), Juta, Kenwyn by Anneli Loubser. You are, of course, free to study the full law report as it appears in the law reports. For your purposes, however, it is sufficient to study the shortened version in Loubser's book. Each judgment in Loubser's book is provided with a summary of the principles which the case deals with, and a short exposition of the facts, followed by extracts from the judgment itself. It is important to study the decisions of the courts, because these demonstrate how the law is applied to a factual situation.

Reference to cases

Just to refresh your memory, we give an example of a reference to a reported case: *Van Zyl NO v Bolton* 1994 (4) SA 648 (C). Van Zyl was therefore the plaintiff, who appeared in his official capacity (here as trustee of an insolvent estate). Bolton was the defendant. The judgment was reported on page 648 of the fourth volume of the South African Law Reports for 1994. The court which gave the judgment was the Cape Provincial Division.

When you wish to refer to a case in your assignments or in the examination, it is not necessary to give the complete reference as discussed above. It is sufficient to give the names of the parties. Further descriptions such as, for example, "NO", "(Pty) Ltd", and "and others" may be omitted.

Activities

In most study units, you will find some activities with our feedback. Try doing these activities yourselves before looking at the feedback.

Self-test questions

At the end of each study unit of this Study Guide, you will find a number of self-test questions with their answers. They are mostly short questions aimed at testing whether you know and understand the content of the relevant chapter of Hockly. You are therefore advised to try to answer the questions and then to compare your answers with the answers which we supply.

NOTE THAT SOME OF THESE ACTIVITIES AND SELF-TEST QUESTIONS MAY APPEAR IN THE ASSIGNMENTS AND IN THE EXAMINATION.

Glossary/Word power

Because the South African common law is of Roman origin, there are several Latin expressions and terms which appear often in the judgments of the courts and other legal literature. Below is a list of such terms and expressions which appear frequently, with their meanings:

<i>animus contrahendi</i>	intention to contract
<i>bona fides</i>	good faith
<i>bona fide</i>	in good faith
<i>cessio bonorum</i>	transfer of property
<i>contra bonos mores</i>	against good morals
<i>curator ad litem</i>	curator for the conduct of a lawsuit
<i>curator bonis</i>	curator to administer someone else's assets on his behalf
<i>de facto</i>	in fact
<i>de iure (jure)</i>	in law
<i>dictum</i>	remark
<i>eiusdem generis</i>	of the same kind or class
<i>et seq</i>	and the following (pages)
<i>ex variis causarum figuris</i>	(arising) from a variety of juristic figures
<i>ibid (ibidem)</i>	in the same place
<i>impossibilium nulla est obligatio</i>	there is no obligation to perform the impossible

<i>infra</i>	below
<i>in solidum</i>	joint and several (liability)
<i>inter alia</i>	among other things
<i>inter se</i>	between (among) themselves
<i>ipso iure (jure)</i>	by operation of law
<i>locus standi in iudicio (iudicio)</i>	capacity to appear in court as a litigant
<i>missio in possessionem</i>	release into possession
<i>mutatis mutandis</i>	with the necessary changes
<i>nomine officii</i>	in his official capacity (by virtue of his office)
<i>nudum pactum</i>	non-binding agreement
<i>nulla bona</i>	no property
<i>obiter dictum</i>	remark in passing
<i>pari passu</i>	simultaneously
<i>persona</i>	person
<i>prima facie</i>	at first sight
<i>pro rata</i>	proportionately
<i>stipulatio alteri</i>	stipulation in favour of a third party
<i>substratum</i>	underlying reason for existence
<i>supra</i>	above
<i>sv (sub voce)</i>	under the word
<i>ultra vires</i>	beyond the scope of its powers
<i>verbatim</i>	word for word

The *Government Gazette*

You will find references to the *Government Gazette* in Hockly and in this Study Guide. The *Government Gazette* is published every Friday by the Government Printer in Pretoria, and contains various items, such as new legislation and also notices required by the provisions of certain statutes.

Study unit 1

INTRODUCTION TO INSOLVENCY LAW

In this study unit, we introduce you to the law of insolvency and to Hockly, the textbook that is prescribed for this course.

We also introduce you to the concept of insolvency and how the law of insolvency is applied to persons such as a debtor who is insolvent, and to a debtor's creditors – that is, to all of whom the debtor owes a substantial amount of money.

NOTE: The paragraph numbers in this study unit, and those that follow, correspond with the paragraph numbers in Hockly, the prescribed textbook.

After completing this study unit you should be able to

- explain the meaning of “insolvency”
- explain the purpose of a sequestration order
- explain the meaning of “estate” and “debtor”
- describe the jurisdiction of the court over the debtor and his estate, and the procedure where courts have competing jurisdiction
- distinguish between the different types of irregularity, and explain how they are condoned
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly 1.1 up to and including 1.6, and 1.7.3.

Omit Hockly 1.7.1. up to and including 1.7.2.

Also study the following:

Magnum Financial Holdings (Pty) Ltd (in Liquidation) v Summerly and another NNO 1984 (1) SA 160 (W) (case[28] in Loubser)

The scenario involving Tenza

The following set of facts may serve as an example of the manner in which a debtor may overburden him- or herself with financial responsibility, thereby becoming **insolvent**. Here is the first scenario in which we mention Tenza, an insolvent whose experience forms a consistent theme of this Study Guide.

Tenza obtained his LLB degree in 2001. After completing his articles of clerkship, he joined the law firm of Blaa & Blaa of Sandton, Johannesburg. As a professional assistant, Tenza earned a gross income of R11 000 per month. Tenza decided that as an attorney he deserved to live in a smart house in Soweto. He therefore borrowed R400 000 from the Payback Bank for the purchase price of his new house, and the bank registered a mortgage bond over this immovable property in order to secure the repayment of the money by Tenza. Tenza then decided that he needed a motor vehicle, and so he borrowed R250 000 from City Motors to purchase his new Mercedes Benz. New suits and party clothing were now also essential, so Tenza purchased, on credit, clothing to the value of R40 000 from various clothing stores in Killarney, a smart suburb of Johannesburg. While Tenza was away for a week on business in Cape Town, a squatter camp sprang up on the empty land adjacent to Tenza's own property. During this week, Tenza's house was also burgled, and most of the new clothes that he had purchased were stolen, together with every item of furniture that he owned. The only assets that Tenza had left were the house and the Mercedes Benz motorcar. The house had declined in value to less than R50 000, however, because the squatters had moved in next door. In fact, Tenza soon found that it was impossible to sell the house. Because of wear and tear, and a "minor accident" on Tenza's way home from a party, the car was now valued at only R90 000.

Tenza has to make the following monthly payments on all the items that he purchased, and on other monthly expenses:

The mortgage bond on the house	R 5 000	Current house value	R50 000
Motor vehicle	R 4 000	Current vehicle value	R90 000
Clothing accounts	R 2 000		
Groceries	R 2 000		
Lights, water, rates and taxes	R 1 500		
Telkom telephone	R 300		
Cellphone	R 400		
Medical aid	R 600		
Insurance	R 800		
Security alarm and armed response	R 800		
TOTAL	R17 400		

At this stage, Tenza still owes the bank R300 000 for the house, and he owes City Motors R150 000 for the Mercedes Benz motor vehicle.

Tenza's debts that he owes to his creditors now total approximately R467 400, and his assets (ie, his possessions, being the house and the vehicle) are valued at R140 000. Tenza's monthly payments total R17 400, while he earns only R11 000, and he has no other

income. Tenza is therefore **insolvent**, because he owes his creditors more than he can pay them, and his **debts (liabilities)** are much higher than his **assets (his possessions)**.

What course of action can be taken by **Tenza's creditors**?

What course of action can be taken by **Tenza**?

The facts relating to this case study will be used throughout this Study Guide.

1.1 Meaning of "insolvency" (ie, see Hockly 1.1)

Note that a person may be insolvent in the sense that his liabilities exceed his assets, such as Tenza in the above example, even though his estate has not yet been sequestered. In fact, sequestration will usually be applied for only when the liabilities already exceed the assets. It is important to remember that the consequences of the Insolvency Act arise only after the debtor's estate has been sequestered. In sections 26, 29, 30 and 31 of the Act, for example, provision is made for the setting aside of some dispositions. (Make sure that you know what is meant by a "disposition". The word "disposition" is specifically defined in section 2 of the Insolvency Act. It is important to know and understand what is meant by a "disposition" for the purposes of insolvency law, and so you will read more about a "disposition" in Hockly 12.1.) Although the dispositions have taken place before sequestration, the relevant sections of the Insolvency Act concerning dispositions may be invoked only after the court has sequestered the debtor's estate.

1.2 Purpose of a sequestration order

The sequestration procedure is aimed mainly at achieving a fair distribution of the available assets among competing creditors of the debtor. In the above example, the Payback Bank, City Motors, Telkom, and all the other creditors of Tenza on the list will be competing creditors, all hoping that through the sequestration procedure they will get back at least **some** of the money owing to them. This is the reason that the court will usually not grant a sequestration order if there is only one creditor. In such a case, there are no **competing** creditors, and the single creditor should use the ordinary procedure for execution to obtain payment of her claim. That is to say, the creditor must, through the courts, issue a summons, prove her case and obtain judgment for the amount owing, and if necessary execute the judgment against the debtor's assets.

Activity 1

In this activity, we test your understanding of the effect of the award of a sequestration order.

Complete the following sentence:

The award of a sequestration order creates a, and creditors who have proved a claim have the right to share with other proved creditors in the proceeds of the estate assets.

Feedback

The award of a sequestration order creates a *concursum creditorum* (concourse or coming together of creditors, for example, the Payback Bank, City Motors, Telkom and the other

creditors on the above list), and creditors who have proved a claim have the right to share with other proved creditors in the proceeds of the estate assets. In the above example, Tenza's assets consist of the vehicle worth R90 000 and the house that is now worth only R50 000, and thus a total of only R140 000 for the creditors to share.

If the debtor's assets are not sufficient to cover the **costs** of sequestration, there is also no sense in sequestrating his estate, because the creditors will then receive nothing from the estate. It would therefore be merely a waste of time and money to sequester the estate. In such a case, the collective procedure for collecting debts (ie, the sequestration process) would serve no purpose, and so the creditors of the debtor would then have to seek **individual** relief against Tenza, by taking judgment against him for nonpayment of debts, and then executing these judgments against Tenza's assets.

1.3.2 Meaning of "debtor"

An external company may be liquidated in South Africa (in terms of the Companies Act 61 of 1973) if it has a place of business in South Africa. If it does not have a place of business in South Africa, its estate may be sequestrated in South Africa under the Insolvency Act, if a South African court has jurisdiction in terms of section 149 of the Insolvency Act.

Remember that in our example above, Tenza is a natural person (a human being) whose estate must be sequestrated, and not liquidated (wound up) as in the case of a juristic person such as a company or a close corporation.

Activity 2

In this activity, you are introduced to the kind of question requiring you to state or list information comprehensively, without discussing any of the items in detail. Knowing about the different types of estate will enable you to distinguish whether a particular estate (eg, Tenza's estate) must be **sequestrated in terms of the Insolvency Act** or whether it must be **liquidated** in terms of an **Act relating to juristic persons**. This activity will also enable you to decide whether or not a particular court has jurisdiction to **sequester** or to **liquidate** a particular estate.

List the various estates that fall within the meaning of the word "estate".

Feedback

Did you list the following five estates, and could you identify which of these applied to Tenza's case study?

- (1) an estate that includes assets and liabilities (eg, Tenza's estate)
- (2) an estate that consists of liabilities only (eg, if Tenza did not own the house and the vehicle)
- (3) the joint estate of spouses married in community of property
- (4) the separate estates of spouses married out of community of property

- (5) the new estate of a debtor whose estate has been sequestrated

To ensure that you understand the meaning of the word “debtor” (Hockly 1.3.2) and how it relates to the meaning of the word “estate”, you should **study** the decision in *Magnum Financial Holdings (Pty) Ltd (in Liquidation) v Summerly and another* 1984 (1) SA 160 (W). There the court held that a trust is not a juristic person, and so it may not be liquidated in terms of the Companies Act. A trust is a debtor in the ordinary sense of the word, however, and therefore a trust estate may indeed be **sequestrated**.

Activity 3

The following four activities test your understanding of the **prescribed** case of *Magnum Financial Holdings (Pty) Ltd (in Liquidation)*. Remember that the list of cases that you should study is set out in Tutorial Letter 101. **It is possible that you may be asked to discuss at least three of these prescribed cases in the examinations. We may also ask you to apply these cases to a given set of facts.**

- (1) Give reasons why the court in *Magnum Financial Holdings* was satisfied that the applicants had made out a case for the relief sought (the urgent grant of a provisional sequestration order).
- (2) Identify the problem faced by the court in *Magnum Financial Holdings*.
- (3) Summarise the authority which the court relied on to solve the problem which it faced.
- (4) Explain the common-law meaning of the phrase “any body corporate”.

Feedback

We suggest the following answers to the activities. Ensure that you have read the relevant case and identified all the issues set out in this activity:

- (1) There had been sufficient service of the papers on the trustee of the trust. (Note that this was not a trustee in terms of the insolvency law, because the estate of the trust had not yet been sequestrated. Instead, the trustee was the trustee in terms of the law of trusts, who administered the trust property for the benefit of the trust beneficiaries.) The one provisional liquidator of the applicant company had *locus standi* to apply for the provisional sequestration of the trust estate. The applicant company had a claim against the trust for about R1,6 million which was due and payable. An act of insolvency in terms of section 8(g) of the Insolvency Act 24 of 1936 had been committed, and the trust estate was also insolvent. It was to the advantage of the trust’s creditors that its estate be sequestrated urgently. Further, the necessary security bond had been duly lodged and also annexed to the court papers. (See p 161 of the law report.)
- (2) The only problem before the court was whether a trust could, at law, be sequestrated. (See p 161 of the law report.)
- (3) No South African case seemed to have dealt with whether a trust could be sequestrated in terms of section 9(1) read with the definition of “debtor” in section 2 of

the Insolvency Act. Therefore the court relied on *Ex parte Milton NO 1959 (3) SA 347 (SR)*. In that case, the Southern Rhodesian court, interpreting a similarly worded section of the Rhodesian statute, approved the voluntary surrender of the estate of an administrative trust created by contract. The trust fell within the definition of a “debtor” and could be described as a debtor in the usual sense of the word. Through its trustee, the trust could borrow money and, as a property owner, be liable for rates and taxes. Creditors would be paid only from the trust’s property. The trustee was not personally liable for debts which he incurred on the trust’s behalf. A *concursum creditorum* could not be established by sequestrating the estates of the donor of the trust property, the trust beneficiaries, or the trustee. By way of comparison, the Rhodesian court also relied on South African decisions concerning a club which owned property apart from its members, who were not liable for its debts beyond the amount of their subscriptions. Such a club was a debtor within the meaning of the Insolvency Act, and its estate could therefore be sequestrated. (See pp 161-162 of the law report.)

- (4) The court gave the common-law meaning of “any body corporate” as an association of individuals capable of holding property and of suing and being sued in its corporate name, or a *universitas* having the capacity to acquire certain rights apart from the rights of the individuals which form it, and having perpetual succession (ie, continuous existence). (See p 163 of the law report.)

1.4.2 Jurisdiction over a debtor and his estate

You will notice that domicile is one of the grounds on which a court has jurisdiction to sequester a person’s estate (Hockly 1.4.2(i)). A person is domiciled at a particular place if he is lawfully present there and has the intention to settle there for an indefinite period (s 1(2) of the Domicile Act 3 of 1992). The available facts in Tenza’s case study indicate that he is domiciled in Soweto, Gauteng.

1.7.3(ii) Hockly Constitution

You may be interested to know that you can read the Constitution of the Republic of South Africa, 1996 on the website of the Constitutional Court at <http://www.constitutionalcourt.org.za/site/home.htm>.

SELF-TEST QUESTIONS

- (1) Explain the main purpose of a sequestration order in respect of Tenza’s estate. (2)
- (2) Give reasons why a sequestration order may not be granted if a debtor has only one creditor or if there are not enough assets to cover the costs of sequestration. (3)
- (3) Explain whether a debtor whose estate is under sequestration may obtain a new estate which does not form part of the sequestrated estate. (2)

- (4) Suppose that Bonzo Ltd is a British company which owns property which is lying in a warehouse in Cape Town harbour. Bonzo Ltd does not, however, have a place of business in South Africa.
- (a) Briefly explain whether the Western Cape High Court, Cape Town has jurisdiction to liquidate Bonzo Ltd. (2)
- (b) Will the Western Cape High Court, Cape Town have jurisdiction to sequestrate Bonzo Ltd's estate? (5)
- (c) Will the Cape Town Magistrate's Court have jurisdiction to sequestrate Bonzo Ltd's estate? (1)
- (5) When will a formal defect in an application for the sequestration of an estate be fatal? (2)
- (6) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

In common parlance, a person may be said to be insolvent when his liabilities, fairly estimated, exceed his assets, fairly valued.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) The main purpose of a sequestration order is to ensure the orderly and fair distribution of a debtor's (Tenza's) assets if his assets are not sufficient to pay all his creditors in full.
- (2) If a debtor has only one creditor, there are no conflicting interests between creditors which must be equitably resolved. If the debtor's assets are not sufficient to cover the costs of sequestration, creditors will derive no advantage from the process of sequestration. Consequently, in such a case sequestration would merely amount to a waste of time and money.
- (3) Because some assets which a debtor has or acquires do not form part of his insolvent estate, it is indeed possible to build up a new estate which does not form part of the estate under sequestration.
- (4) (a) Because Bonzo Ltd does not have a place of business in South Africa, a South African court will not have jurisdiction to wind up the company.
- (b) Because the company may not be wound up in terms of the Companies Act, it is a "debtor" for the purposes of the Insolvency Act. The estate of the company may therefore be sequestered by a South African court. Because the

company owns property which is situated within the area of jurisdiction of the Western Cape High Court, Cape Town, that court will have jurisdiction to sequester the company's estate.

- (c) A magistrate's court has no jurisdiction to grant an order of sequestration.
- (5) A formal defect in an application will be fatal if the defect causes a substantial injustice to creditors and that prejudice cannot be put right by a court order.
- (6) This statement is false. In **common parlance**, a person may be said to be insolvent when he is unable to pay his debts. The **legal test of insolvency**, however, is whether the debtor's liabilities, fairly estimated, exceed his assets, fairly valued. See Hockly 1.1.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 2

VOLUNTARY SURRENDER

In this study unit, we introduce you to the methods by which the estate of Tenza (or any other debtor as specially defined by the Insolvency Act) may be sequestrated.

After completing this study unit you should be able to

- distinguish between the two methods of sequestration of a debtor's estate, namely
 - the sequestration of Tenza's estate by Tenza (the debtor) himself, or
 - the sequestration of Tenza's estate by one or more of his creditors
- identify the possible applicants at an application for sequestration of an estate
- list and explain the requirements which must be satisfied before the court will accept the surrender of Tenza's estate
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

Study Hockly chapter 2 up to and including 2.2.3.

Also study the following:

***Ex parte Henning* 1981 (3) SA 843 (O) (case [29] in Loubser)**

2.1 Who may apply

You will note that all the members of a partnership must apply for the sequestration of the partnership estate. There are two exceptions. The one regarding "special partnerships" can be ignored because the legislation relating to it has in the meantime been repealed. The other relates to partners *en commandite*. In this type of partnership, there are one or more ordinary partners and one or more partners *en commandite*. Unlike ordinary partners, the partners *en commandite* are not liable to creditors for the partnership debts. Nor are they liable to copartners for any partnership losses which may be incurred. A partner *en commandite* merely makes a contribution (whether in money or goods) towards the partnership assets, and, should the partnership fail, all he would lose would be this contribution. For this reason, he need not be a party to an application for the voluntary surrender of a partnership estate. It is sufficient if all the ordinary partners make the application.

Activity 1

In this activity, we test your understanding of the relationships involved in Hockly 2.1, so try to do it without looking at your textbook: only if you cannot proceed, then look at Hockly 2.1. Fill in the blanks in the following incomplete statements about debtors and the people who may apply for the voluntary surrender of the debtor's estate.

- (1) Tenza is the insolvent debtor and voluntary surrender may therefore be sought by Tenza himself. State which other person may apply for the voluntary surrender on behalf of Tenza.
- (2) If Tenza is insane, explain who must apply for the voluntary surrender of his estate.
- (3) Tenza's uncle and aunt, Mr and Mrs Zondi, were married in community of property in 1991 and are now insolvent; explain, giving reasons for your answer, who may now apply for the voluntary surrender of their estate.
- (4) If Tenza were to die, who would apply for the voluntary surrender of his estate?
- (5) Tenza's cousins, Mr Abel, Mrs Brown and Mr Charles, run a greengrocer's shop in partnership as ordinary partners, but the partnership liabilities heavily exceed the partnership assets. Explain who must apply for the voluntary surrender of the partnership estate.

Feedback

- (1) Tenza's **expressly authorised agent** may apply on his behalf.
- (2) Voluntary surrender may be sought by **the person entrusted with administering Tenza's estate** (Tenza's *curator bonis*).
- (3) Mr and Mrs Zondi were married in community of property in 1991, and are now insolvent; voluntary surrender may be sought by **Mr and Mrs Zondi**.
- (4) Voluntary surrender of his estate may be sought by **the executor of Tenza's deceased estate**.
- (5) Voluntary surrender of the partnership estate may be sought by **Mr Abel, Mrs Brown and Mr Charles all together. Alternatively, the application may be brought by their expressly authorised agent**.

2.2.3 Sequestration will be to the advantage of creditors

With regard to the requirement of advantage to creditors at an application for the voluntary surrender of the estate, note the **prescribed** decision in *Ex parte Henning* 1981 (3) SA 843 (O). In this case, the debtor's wife, to whom he was married out of community of property, made a monthly contribution from her salary to pay his (the debtor's) creditors. The question was whether this fact should have been taken into account to determine whether sequestration would be to the advantage of the creditors. The court held that it could not be

taken into account, because it was uncertain whether the debtor's wife would continue working, and would continue to make the monthly contribution. She could not be compelled to do so, because her husband's creditors were not her creditors.

Activity 2

In this activity, we test your understanding of the **prescribed** case of *Ex parte Henning*, and your ability to follow the arguments presented for the litigants.

- (1) The respondent (Rand Bank) opposed the application for voluntary surrender. One of the respondent's grounds of opposition was that the application did not comply with the requirements of section 6(1) because the applicant's assets did not cover the costs of sequestration payable from the free residue. Explain how the court resolved this issue.
- (2) As regards the requirement of advantage to creditors, the respondent argued that it would be much better off if the application for voluntary surrender were refused and the applicant were compelled to continue paying the respondent for nine years. Describe which test the court laid down as the proper one to be applied in these circumstances.
- (3) The respondent argued that the applicant was approaching the court to avoid paying the respondent's claim. Explain how the court disposed of this point.

Feedback

- (1) The court decided that even if the sequestration costs had to be available at the time of the application, the applicant's assets would probably fetch R1 030 and would therefore cover the sequestration costs which the parties had agreed would run to about R1 000. (See p 847 of the law report.)
- (2) The court held that the test was not to compare the respondent's position at the time of immediate voluntary surrender of the applicant's estate with the respondent's position if the monthly debt payments were continued for nine years. The question was merely whether the court papers showed whether voluntary surrender would be to the advantage of all the creditors. (See p 847 of the law report.)
- (3) The respondent argued that the applicant was probably bringing the application not to benefit the creditors, but merely to avoid paying the claim in favour of the respondent. The court decided that, on the facts, this argument lacked substance. If the applicant had wished to avoid paying the claim, it would have suited him and his spouse for her to stop working and sit back without paying anything, so that his creditors could sequester his estate. (See p 848 of the law report.)

SELF-TEST QUESTIONS

- (1) State the basic difference between voluntary surrender and compulsory sequestration.
- (2)

- (2) Explain whether one of the partners or one of the spouses respectively may apply for the sequestration of a partnership estate or the joint estate of persons married in community of property. (3)
- (3) Describe what the court must be convinced of prior to granting an order for the voluntary surrender of Tenza's estate. (4)
- (4) What is the "free residue" of an insolvent estate? (5)
- (5) Suppose Tenza's brother Alf applies for the voluntary surrender of his estate. It appears that his wife receives a good income and that from this she contributes a substantial amount towards the payment of his debts, but that she will definitely not continue to do so if Alf's estate is sequestrated. Should the court dismiss the application merely because it would be more to the advantage of Alf's creditors if Alf's wife were to continue helping to pay his (Alf's) debts? Give reasons for your answer. (3)
- (6) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.
- A debtor who has no assets and only liabilities cannot surrender his estate. (2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) In the case of voluntary surrender, the debtor himself applies for the sequestration of his estate. In the case of compulsory sequestration, a creditor applies for the sequestration of the debtor's estate.
- (2) In terms of section 3(2) of the Insolvency Act, all the partners (except partners *en commandite*) must apply for the surrender of the partnership estate. In terms of section 17(4) of the Matrimonial Property Act 88 of 1984, in a marriage in community of property both spouses must apply for the surrender of their joint estate.
- (3) In terms of section 6(1) of the Insolvency Act, the court must be satisfied that (a) all the prescribed formalities have been adhered to (notices, etc); (b) Tenza's estate is indeed insolvent; (c) there is sufficient realisable property in the free residue of Tenza's estate to defray the costs of sequestration; and (d) it will be to the advantage of Tenza's creditors if his estate is sequestrated.
- (4) The free residue of an insolvent estate is that part of the estate which is not subject to any right of preference by reason of a special mortgage, legal hypothec, pledge, or right of retention.
- (5) This question relates to the decision of the court in *Ex parte Henning* 1981 (3) SA 843 (O). In the *Henning* case it was decided that this factor is too vague or uncertain to

take into account in evaluating whether sequestration will be to the advantage of the creditors. The court will therefore not dismiss the application merely because the creditors will be in a better position if Alf's wife continues to assist him in paying his debts.

- (6) This statement is true. A logical result of the requirement that the debtor must own sufficient property to meet the costs of sequestration is that a debtor who has no assets and only liabilities cannot surrender his estate. See Hockly 2.2.2.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 3

VOLUNTARY SURRENDER

In this study unit, we shall introduce you to the formalities that must be complied with for the voluntary surrender of an estate, and also to the effect of a notice of surrender of a debtor's estate. In this study unit, we shall also guide you through the application for the surrender of an estate, and we shall consider the court's discretion regarding the surrender of the debtor's estate.

After completing this study unit you should be able to

- describe the preliminary formalities in an application for voluntary surrender and describe the procedure with respect to an application for voluntary surrender
- identify the consequences of the publication of a notice of intention to surrender
- explain the difference between a rehabilitation order and the setting aside of a sequestration order
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIAL FOR THIS STUDY UNIT

Study Hockly chapter 2 from 2.3 to the end.

Also study the following:

***Ex parte Henning* 1981 (3) SA 843 (O) (case [29] in Loubser)**

2.3.1 Notice of intention to surrender

If a debtor such as Tenza decides to surrender his estate he will first have to publish a notice of surrender in the *Government Gazette* and in a newspaper circulating in the magisterial district in which he resides, or if he is a trader, in the district where he has his principal place of business. The purpose of a notice of surrender is to alert Tenza's creditors to the intended voluntary surrender of his estate, in case they should wish to oppose it.

Activity 1

In this activity, we test your knowledge of the requirements for preparing an application for voluntary surrender, and your ability to apply that knowledge to a set of facts in practice. You are an attorney practising in Johannesburg in the jurisdiction of the South Gauteng High

Court, Johannesburg. You have to draft the notice of intention to surrender the estate of Mr Tenza Zondi, a lawyer residing at 6 Blue Street, Soweto. His creditors are Mr Dalloway, Mr Etheridge, and Mr Poggenpoel.

- (1) Describe the publications in which you will have to make sure that the notice is published.
- (2) Explain what information should be contained in the notice.
- (3) State what time limits you should bear in mind when calculating the date when the application for voluntary surrender will be heard.
- (4) State two methods of proving that you have published the notice correctly.
- (5) Describe which other steps you should take; why; and how you will prove that you have taken them.

Feedback

- (1) You will have to publish the notice in the *Government Gazette* and in a newspaper circulating in the magisterial district of Soweto (in which Tenza resides).
- (2) The notice must contain the following information:

Debtor's personal details

The debtor's full names (Tenza Zondi); his residential address (6 Blue Street, Soweto); and his occupation (lawyer).

Court details

The date (..... 20...) and the particular division of the High Court before which the application will be made (the South Gauteng High Court, Johannesburg).

Details of the statement of affairs

When (..... 20...) and where (the Master's Office in Johannesburg) the statement will lie for inspection.

- (3) The date for the hearing of the application will have to allow for publication in the *Government Gazette* and the newspaper no more than 30 days, and no fewer than 14 days, before the date of the hearing.
- (4) Either you file copies of the relevant *Government Gazette* and the newspaper with the South Gauteng High Court, Johannesburg, or else you attach cuttings from the relevant *Government Gazette* and the newspaper to an affidavit, and file them with the court.
- (5) Notice of intention to surrender must be given to each of Tenza's creditors (s 4(2)). Within seven days of publishing the notice of surrender in the *Government Gazette*, Tenza, or you on his behalf, must deliver or post copies of the notice to Mr Dalloway,

Mr Etheridge, and Mr Poggenpoel, if their addresses can be established. The reason for this requirement is the protection of Tenza's creditors. The posting of the notices is proved by an affidavit, either by Tenza or by you as his attorney, stating that the notices have been sent.

2.3.2 Notice to creditors and other parties

The Insolvency Second Amendment Act 69 of 2002 was published in *Government Gazette* 24285 Notice 121 of 22 January 2003. However, it had already come into effect on 1 January 2003 (s 10 of that amending Act).

In respect of the notice of surrender of an estate, the Amendment Act replaces **section 4(2)** of the Insolvency Act 1936 so as to provide that within a period of seven days as from the date of publication of the notice of surrender in the *Government Gazette* the petitioner must deliver or post a copy of the said notice to every one of the creditors of the debtor in question whose address he or she knows or can ascertain.

In addition, within that period a copy of the notice must be furnished to every registered trade union that represents any of the debtor's employees, to the employees themselves, and to the South African Revenue Service.

These notification requirements also apply to applications for compulsory sequestration (see **section 9(4A)** of the Insolvency Act 24 of 1936 and study unit 4 below).

2.3.3 Preparation and lodging of statement of affairs

In *Ex parte Henning*, the statement of affairs that lay for inspection did not contain the personal information (Annexure VIII). But it was clear that no creditor had been prejudiced by this defect in deciding whether to oppose the application. In the circumstances, the court was prepared to condone the defect.

Activity 2

In this activity, we test your ability to classify information when preparing the statement of affairs in an application for voluntary surrender. The column on the left contains some information, and the column on the right contains a descriptive heading under which the information should be classified. Complete the table by showing the correct links between the two columns.

Information to be classified	Descriptive heading
Ledger	Cause of debtor's insolvency (Annexure VII)
Car held by C Garage as security for payment for repairs	Personal information about the debtor (Annexure VIII)
Inability to pay a huge debt for hospitalisation	List of accounting books used by the debtor (Annexure VI)

Mortgage over house in Soweto, for R400 000 in favour of Payback Bank	List of immovable property (Annexure I)
Dates of previous insolvency and rehabilitation	List of movable assets subject to a lien (Annexure V)

Feedback

Information to be classified	Descriptive heading
Ledger	List of accounting books used by the debtor (Annexure VI)
Car held by C Garage as security for payment for repairs	List of movable assets subject to a lien (Annexure V)
Inability to pay a huge debt for hospitalisation	Cause of debtor's insolvency (Annexure VII)
Mortgage over Soweto house, for R400 000 in favour of Payback Bank	List of immovable property (Annexure I)
Dates of previous insolvency and rehabilitation	Personal information about the debtor (Annexure VIII)

2.4.1 Stay of sales in execution

You will notice that the court or the Master may order that an asset that has been attached in terms of a judgment should nevertheless be sold, despite the publication of a notice of intention to surrender. At that stage, the application has not yet been considered by the court, and the debtor's estate has not yet been sequestrated. For this reason it is usually ordered that the proceeds of the sale be held by the sheriff or the Master, pending the result of the application. If the application is granted, the proceeds of the sale form part of the insolvent estate, and they are distributed among the creditors in accordance with the provisions of the Insolvency Act. If the application is dismissed, however, the proceeds are distributed among the creditors as in the case of an ordinary sale in execution of a judgment.

Activity 3

In this activity, we test your ability to apply section 5(1) of the Insolvency Act to a set of facts. Tenza's car was attached (seized) by Sheriff C on the instruction of Tenza's creditor, Coty Motors, in execution of a judgment for the payment of R150 000. Tenza has since duly published a notice of intention to surrender his estate. Even though C knew about the publication of the notice he nevertheless sold the car for R150 000 to D, who claims delivery of the car. Is D entitled to delivery of the car?

Feedback

Because Tenza has published the notice of intention a sale of the attached car is unlawful. The High Court, however, may still order the sale of the car to proceed and direct how the proceeds of the sale should be applied (s 5(1) read with s 2 (definition of “court”). Yet the facts do not show that the court has ordered this particular sale to proceed. Because Sheriff C has contravened section 5(1) by selling the car to D, the sale is illegal. D may therefore not claim delivery of the car, and his remedy would be a claim for damages against Sheriff C.

2.4.3 Potential compulsory sequestration

A creditor may apply for compulsory sequestration if the debtor has published a notice of intention to surrender and then fails to make his application on the given date. It is important to note that a creditor may use this failure as a ground for compulsory sequestration only in so far as the notice of intention to surrender has not yet been properly withdrawn or has not lapsed. It appears from section 6(2) that a notice of intention to surrender lapses 14 days after the day advertised for the hearing of the application. It follows that if a creditor wishes to apply for compulsory sequestration on the ground of the debtor’s failure to apply for voluntary surrender on the advertised day he has to do so before the lapse of 14 days. If he waits longer than 14 days, the notice of intention to surrender will already have lapsed, and the debtor’s failure may no longer serve as a ground for compulsory sequestration.

2.4.5 Lapse of notice of surrender

Note that the debtor must apply for surrender within the period of 14 days after the advertised date, but the court may accept or decline such an application after the lapse of the 14-day period.

2.5.1 Form and contents of application

The application for voluntary surrender is brought by way of a notice of motion supported by affidavit. (An affidavit is a written statement made on oath or affirmation in accordance with the Justices of the Peace and Commissioners of Oaths Act 16 of 1963.) This founding affidavit is used to persuade the court that the four requirements for voluntary surrender have been satisfied. This affidavit must therefore contain specific information.

Activity 4

In this activity we test your ability to prepare the notice of motion by means of which the debtor applies to the court for the voluntary surrender of his or her estate. In this activity the debtors are Tenza Zondi and his wife Mpho Zondi; they are married in community of property. The couple are domiciled in Soweto, Gauteng, within the area of jurisdiction of the South Gauteng High Court, Johannesburg. Study the specimen notice of motion that appears in par 1.1 in Appendix I of Hockly on page 275, and then draw up the appropriate notice of motion.

Feedback

See this notice of motion:

**IN THE HIGH COURT OF SOUTH AFRICA
(SOUTH GAUTENG HIGH COURT, JOHANNESBURG)**

CASE NUMBER 175/2009

In the matter of

Tenza Zondi (APPLICANT)
Mpho Zondi (APPLICANT)

NOTICE OF MOTION

TAKE NOTICE that application will be made on behalf of the above applicants on the 3rd day of July 2009 at 10h00 or as soon thereafter as Counsel may be heard for an order in the following terms.

1. That the surrender of the estate of the applicants is accepted.
2. That alternative relief is granted to the applicants.

FURTHER TAKE NOTICE that the affidavits of Tenza Zondi and Mpho Zondi annexed hereto will be used in support of the application.

KINDLY place the matter on the role for hearing accordingly.

DATED at Johannesburg this 11th day of June 2009.

James, Bodibe and Rampersad
ATTORNEY FOR THE APPLICANTS
39 Blue St
Johannesburg
(Reference: Mr AB Bodibe/jvd/1745)

TO:
THE REGISTRAR OF THE HIGH COURT
SOUTH GAUTENG HIGH COURT, JOHANNESBURG

AND TO:
THE MASTER OF THE HIGH COURT
SOUTH GAUTENG HIGH COURT, JOHANNESBURG

It is important to note that the notice of motion has to mention both the spouses as the applicants in this matter, because as spouses married in community of property they are applying to surrender their joint estate (see Hockly 1.3.1 and 2.1 final bullet, and section 17(4) of the Matrimonial Property Act 88 of 1984).

Activity 5

In this activity, we test your knowledge of Hockly 2.5.1 regarding the contents of the founding affidavit in support of an application for voluntary surrender.

Your partner in an attorney's firm walks into your office and says, "It's been some time since I last drafted a founding affidavit in an application for voluntary surrender. Please remind me quickly of the essential points that I must mention."

Feedback

The essential points are as follows:

- (1) the full name, status, occupation, and address of the applicant (in the case study it would be the name and particulars of Tenza Zondi (if you are drafting the affidavit for Tenza; a separate affidavit will also have to be drawn up for Tenza's wife, Mpho (see Activity 4 above))
- (2) an allegation that the debtor is insolvent; facts establishing this
- (3) an explanation of how the insolvency came about
- (4) an averment that the applicant owns realisable property of sufficient value to defray all the costs of sequestration
- (5) an allegation that it will be to the advantage of creditors if the debtor's estate is sequestrated, amplified by facts supporting the allegation
- (6) details of any salary or other income which the debtor is receiving
- (7) any other information which may influence the court in granting or refusing the surrender
- (8) a description of the procedural steps followed by the applicant prior to bringing the application, supported by documents proving that each step has been taken

2.8 Setting aside sequestration order

According to section 129(1)(b) of the Insolvency Act, one of the consequences of a rehabilitation order is that the debtor (Tenza in the case study) is discharged from all debts the cause of which arose before sequestration (except debts which arose out of fraud on his part). Even if all pre-sequestration debts have not been paid in full from the proceeds of the estate assets (which is usually the case), a rehabilitation order enables the debtor to start building up a new estate without the possibility of being harassed by "old" creditors who have not been paid in full. If the debtor is not rehabilitated, but the sequestration order is simply set aside, this consequence does not follow. Accordingly, the debtor then remains fully liable for all debts which existed before the granting of the sequestration order.

SELF-TEST QUESTIONS

- (1) Suppose that Tenza publishes a notice of intention to surrender his estate 33 days before the advertised date on which the application will be made. Explain whether the court will grant his application for surrender. (8)
- (2) Explain whether Tenza, as the applicant for voluntary surrender, is obliged to obtain an independent valuation of his assets for the purposes of his statement of affairs, or whether he may value his assets himself. (2)
- (3) Suppose that the court authorises the sale of attached assets after a notice of intention to surrender has been published. What order will the court usually make with respect to the proceeds of the sale? (4)
- (4) Suppose that Tenza publishes a notice of intention to surrender, but fails to apply for surrender of the estate on the given date. What is the possible consequence of this step? (3)
- (5) State when a notice of intention to surrender lapses. (3)
- (6) Explain whether the court is obliged to grant an application for voluntary surrender after the applicant has proved the requirements set out in section 6(1) of the Insolvency Act. (1)
- (7) Name an example of a case where the court will order that the costs of an unsuccessful opposition to an application for voluntary surrender form part of the costs of sequestration. (2)
- (8) Name one difference between the consequences of rehabilitation and of the setting aside of a sequestration order. (3)
- (9) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

When the debtor applies for voluntary surrender, the debtor's affidavit, verifying that the statement of affairs is true and complete and that every estimated amount contained in it is fairly and correctly estimated, may be attested by the applicant's attorney.

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) Authority on this question is now divided. According to most of the authority in case law it is a fatal defect if the advertisement is published more than 30 days before the

advertised date of the application (see, for example, *Ex parte Oosthuysen* 1995 (2) SA 694 (T) at 695-698). On this authority the court will therefore dismiss the application. However, in *Ex parte Harmse* 2005 (1) SA 323 (N) at 329, it was held that such a failure is a formal defect or irregularity as envisaged by section 157(1) of the Insolvency Act. It does not therefore invalidate the application unless it has caused an injustice that cannot be remedied by a court order. On this authority the court will therefore not dismiss the application. So the answer to this question depends on whether the relevant application takes place in the jurisdiction of the North Gauteng High Court, Pretoria (which follows the authority of its Full Bench in *Ex parte Oosthuysen*) or whether it takes place in the jurisdiction of the Kwa-Zulu Natal High Court (which follows the authority of its Full Bench in *Ex parte Harmse*).

- (2) Unless the Master orders otherwise, Tenza is not obliged to have his assets valued by an independent valuer. If he nevertheless does so, the costs of the valuation will not form part of the sequestration costs.
- (3) The court will order that the proceeds of the sale be kept by the Master or the sheriff, pending the outcome of the application for voluntary surrender. If the application succeeds, the proceeds will be paid to the trustee for distribution under the provisions of the Insolvency Act. If the application is dismissed, the proceeds will be applied in paying the judgment creditor(s).
- (4) On the basis of this failure, a creditor may apply for compulsory sequestration. But he will have to make his application within 14 days after the day advertised for the application for voluntary surrender, because the notice of intention to surrender lapses after that.
- (5) A notice of intention to surrender lapses if the court dismisses the application, if the notice is properly withdrawn, or if the debtor fails to apply for surrender of the estate before the lapse of 14 days after the day mentioned in the notice.
- (6) Even if the requirements concerned are proved, the court still has a discretion to dismiss the application.
- (7) If an opposing creditor has put new facts before the court which have been of material importance in the court's exercise of its discretion to grant or to dismiss the application, the court will usually order that the costs of opposition form part of the costs of sequestration.
- (8) If an insolvent is rehabilitated he is discharged from all debts (except debts arising from fraud) the cause of which arose before sequestration. This consequence does not follow when a sequestration order is set aside. The position then is simply as though the debtor's estate was never sequestrated.
- (9) This statement is false. In an application for voluntary surrender the applicant debtor's affidavit, verifying that the statement of affairs is true and complete and that every estimated amount contained in it is fairly and correctly estimated, may **not** be attested by the applicant's attorney (*Ex parte Du Toit* 1955 (3) SA 38 (W)). See Hockly 2.3.3(i). Because the word "not" was missing from the statement in question (9), the entire statement is false.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 4

COMPULSORY SEQUESTRATION

In this study unit, we introduce you to the sequestration of the estate of a debtor, such as Tenza, when one or more of Tenza's **creditors** apply for the sequestration of Tenza's estate.

After completing this study unit you should be able to

- name the requirements for the granting of a compulsory sequestration order and explain what type of claim a creditor must have in order to apply for compulsory sequestration
- name the different types of acts of insolvency and the elements of each, and apply them to different problems or case studies
- explain what is understood under the requirement of "advantage to creditors" and apply your understanding of it to different problems or case studies
- define the concept of friendly sequestration, explain the approach of the courts to an application based on a friendly sequestration, and identify and solve a case study relating to such application
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

Study Hockly chapter 3 up to and including 3.1.4.

Also study the following:

***Epstein v Epstein* 1987 (4) SA 606 (C) (case [32] in Loubser)**

3.1 Requirements for the granting of a compulsory sequestration order

Note how the requirements for the granting of a compulsory sequestration order differ from the requirements for the granting of an application for voluntary surrender. Briefly, the differences are the following:

- (1) An applicant for compulsory sequestration must prove a certain type of claim against the debtor.

- (2) An applicant for compulsory sequestration does not need to prove specifically that there are sufficient assets to cover the costs of sequestration. But the absence of these assets will often lead to the conclusion that sequestration will not be to the advantage of creditors.
- (3) An applicant for compulsory sequestration does not necessarily have to prove that the debtor is indeed insolvent. It is sufficient if he can prove an act of insolvency.
- (4) The onus of proof with respect to the requirement of advantage to creditors is lighter in the case of compulsory sequestration than in the case of voluntary surrender.

3.1.1 Applicant entitled to apply in terms of s 9(1)

Note that the word “liquidated” means that the amount of the claim has been fixed or determined. The word “liquidated” has nothing to do with whether an amount is already due and payable. Accordingly, a claim may be liquidated, although it becomes enforceable only in the future. But a conditional claim (ie, one the enforceability of which depends on the happening of an uncertain future event) is not a liquidated claim.

3.1.2 Debtor committed act of insolvency or is insolvent

3.1.2(i)(b) Failure to satisfy judgment

You will notice that section 8(b) of the Insolvency Act actually defines two acts of insolvency. Note that the second one can be committed only if the debtor was not present when the sheriff arrived to execute the warrant. If in such a case the sheriff could not find disposable property to attach, and if he so declares in his return, the second act of insolvency is committed. The first act of insolvency is involved when the debtor was indeed present. Only if two elements are present is this act of insolvency committed. First, the sheriff must have requested the debtor to satisfy the judgment or to indicate sufficient disposable property to satisfy the judgment. Second, the debtor must have failed to comply with any of the sheriff's requests.

Section 8(b) concerns the nonsatisfaction of the judgment of a “court”. Section 2 provides that the word “court” in section 8 means a division of the High Court or a magistrate's court. On the face of it, it therefore seems that a judgment of a small claims court cannot give rise to the act of insolvency as defined in section 8(b). According to section 41(2) of the Small Claims Courts Act 61 of 1984, however, a judgment of a small claims court is executed as though it were a judgment of the magistrate's court. So it seems that such a judgment may also give rise to an act of insolvency in terms of section 8(b).

3.1.2(i)(g) Notice of inability to pay

According to section 8(g) of the Insolvency Act it is an act of insolvency if a debtor gives notice in writing to a creditor that he is unable to pay one or more of his debts. In principle one looks only at the content of the notice to determine whether this act of insolvency has been committed, and not at what the debtor actually intended. It appears from remarks by the court in *Du Plessis en 'n ander v Tzerefos* 1979 (4) SA 819 (O) 835-837 that the notice

will still be an act of insolvency even if the creditor has obtained the document by means of fraud. But in that case, the court will take this fact into account when exercising its discretion whether to sequestrate the estate.

3.1.2(i)(h) Inability to pay debts after notice of transfer of business

The act of insolvency mentioned in section 8(h) of the Insolvency Act is linked to section 34 of the Insolvency Act. Accordingly, you should read Hockly 12.6 before you look at section 8(h). Look also at the definition of “trader” in section 2 of the Insolvency Act, and note that a farmer is not regarded as a “trader”. Note also that the act of insolvency is committed if the trader has published the notice and is then unable to pay all his debts. It follows that the act of insolvency is still committed if the trader cannot pay a debt which bears no relation to his business.

Activity 1

In this activity, we stress the chief purpose served by the acts of insolvency set out in section 8.

Describe the main purpose that an act of insolvency serves.

Feedback

The main purpose served by an act of insolvency is that the creditor wishing to apply for the compulsory sequestration of the debtor’s estate need not prove that the debtor is in fact insolvent.

Activity 2

This activity helps you to remember the act of insolvency laid down in section 8(g), a ground that is particularly important because it is often the basis of a “friendly sequestration” (see Hockly 3.1.4). The activity also gives you practice in drafting an attorney’s letter on behalf of a client.

You are an attorney. Your client, Tenza Zondi, is experiencing financial difficulties: he owes Mr Xaba R100 000, Mr Yen R50 000, and Mr Zin R60 000. His assets, at this stage, total R60 000. He authorises you to write a letter on his behalf to his creditors, stating his financial circumstances and inability to meet his commitments, and suggesting the terms for paying off the debts in instalments. Draft the body of a letter which you may send to Tenza’s creditors.

Feedback

Here is a suggested draft of the letter to Mr Xaba:

Dear Sir

MR T ZONDI: OFFER TO PAY DEBTS IN INSTALMENTS

Mr T Zondi has authorised me to write this letter to his creditors on his behalf in regard to a proposed settlement.

Mr Zondi is apparently experiencing some difficulty in settling his creditors' accounts in full, and he is accordingly compelled to try to settle them by instalments. It appears that he owes you R100 000, Mr Yen R50 000, and Mr Zin R60 000. His assets total R60 000. Because his liabilities exceed his assets, he is insolvent.

It is in the interest of Mr Zondi's creditors to consider compromising his debts, and he is therefore prepared to offer settlement by instalments of R300 per month to each creditor for the first three months commencing on the first day of May of this year, whereafter the position will be reconsidered with a view to higher instalments.

Yours faithfully

The wording of this suggested letter has been taken largely from the one in *Goldblatt's Wholesale (Pty) Ltd v Damalis* 1953 (3) SA 730 (O). In that case, however, Mr Damalis was held to lack the authority to have the letter written on behalf of his wife, Mrs Damalis. As a result, the sending of that letter was not an act of insolvency. The case therefore highlights the importance of an attorney's obtaining proper authority from the client before taking steps on the client's behalf.

Activity 3

The following notice appeared in the *Lingalunga Times*, which circulates in the district of Lingalunga:

NOTICE OF SALE OF BUSINESS

NOTICE is hereby given in terms of section 34 of the Insolvency Act 24 of 1936, as amended, that A BAKER, carrying on business as LINGALONGA GENERAL DEALER at 123 Charles Street, Lingalonga, has sold the business to D Dooka, who will, as from 40 days after publication hereof, carry on the said business for his own benefit and account. – BLAA & BLAA ATTORNEYS, 1st Floor, Rex Building, 456 India Street, Lingalonga. Tel 123 456. Ref: BLaajkl/ROL789.

- (1) Explain the effect of the publication of this notice.
- (2) Suppose that Baker has three creditors: he owes Paulo R100, Bheki R500, and Chad R6 000. Describe the significance of a telephone call from Baker to Bheki to say that he cannot pay the R500.

- (3) Explain whether your answer would be different if Baker had said that he refused to pay Bheki on the grounds that the tinned food supplied by Bheki had subsequently proved to be rotten, and Baker had told Bheki to take it back.

Feedback

- (1) On the publication of a notice in terms of section 34(1), every liquidated liability of Baker in connection with his business which would become due at some future date falls due immediately if the creditor concerned demands payment (s 34(2)).
- (2) Note that the telephone call does not constitute an act of insolvency under section 8(g): although Baker has given notice to Bheki that he is unable to pay the debt, the telephone call is not written notice. The importance of Baker's telling Bheki that he cannot pay the R500 is that proof of inability to pay this debt may serve as proof that Baker cannot pay all his debts, and therefore that Baker has committed an act of insolvency under section 8(h).
- (3) Baker's refusal to pay Bheki for the reasons stated above does make a difference: evidence that Baker was unwilling or had refused to pay the debt of R500 is not sufficient to establish an act of insolvency in terms of section 8(h).

3.1.3 Reason to believe sequestration will be to advantage of creditors

Reference is made to section 23(5) in connection with the possibility that sequestration may be to the advantage of creditors on the ground that a large part of the debtor's future salary will be available to creditors. In the meantime, read Hockly 5.3.2 in this regard. The basic principle (as appears from ss 23(9) and (5)) is that an insolvent may retain for his own benefit the income that he earns from his own work after the sequestration of his estate. Accordingly, it does not fall into his insolvent estate. But the Master may determine that a part of that income which is not required for the maintenance of the insolvent and his dependants must be paid over to the trustee for the benefit of the creditors.

Activity 4

In this activity, we test your understanding of the requirement "advantage to creditors", applying it to a case study, and also give you practice in planning an argument by writing down brief notes.

You are an advocate. Attorney A acting for creditor C has instructed you to apply for the sequestration of debtor D's estate. In the brief sent to you by A are papers indicating the following facts: D is unemployed, but has recently paid large amounts of money to P, Q, and R for reasons that remain vague. D has been staying with his father to save money. D owns a car worth R50 000. D owes C R50 000, E R30 000, and F R45 000. All the creditors are ordinary creditors. E and F are about to take judgment against D, so that they may have his car sold in execution.

As you work through the papers and make notes for your argument in court, which aspects would you jot down to form an outline on the requirement "advantage to creditors"?

Feedback

Advantage to creditors

Creditors

Does sequestration favour all, or the general body, of D's creditors? (See the comparison between a situation of "no sequestration" and a situation of "sequestration" below.)

A not-negligible dividend

Rough calculation: The car is worth R50 000. If it were sold, then, allowing R10 000 to cover the costs of sequestration, R40 000 would remain for distribution among D's concurrent creditors as a dividend. Even on the basis of this asset only, there would be a dividend calculated as follows:

Free residue after payment of costs of sequestration: R40 000

Concurrent debts: R125 000

Dividend: $R40\,000/R125\,000 \times 100 = 32$.

It follows that the dividend would be 32 cents in the rand. That would be a substantial (not-negligible) dividend.

The assets in the free residue may be increased still further if the trustee were to use the machinery of the Insolvency Act for setting aside dispositions (because D's unexplained payments to P, Q, and R look suspect).

A comparison between a situation of "no sequestration" and a situation of "sequestration"

No sequestration	Sequestration
E or F will take judgment and execute on D's assets, principally his car. As a result, the value of D's assets will be reduced, and it will become less likely that C will be paid in full. E or F will be preferred to C. Alternatively, D may decide to sell his car and then pay E and F as much as possible, leaving very little in his estate should C decide to take judgment and have it executed.	If sequestration is ordered, the free residue of D's insolvent estate may be fairly distributed as a dividend among his creditors. The trustee may succeed in setting some dispositions aside, thereby further increasing the possible dividend.

The onus of proving the advantage to creditors remains on C as the applicant for compulsory sequestration

To strengthen the case for sequestration I must examine the papers for evidence that D may have committed an act of insolvency that had the effect of preferring one of his creditors (s 8(c)). In this regard, I should look at those unexplained payments by D to P, Q, and R.

3.1.4 “Friendly” sequestration

In this regard, study the **prescribed** case of *Epstein v Epstein* 1987 (4) SA 606 (C) well to obtain an understanding of the approach of the courts to “friendly” sequestrations. Note that the concurrent creditors in that case would not have received anything out of the estate, because the Receiver of Revenue (now called the Commissioner for the South African Revenue Service) had a preferent claim with respect to arrear income tax, which would in any event have swallowed up everything that might have remained after payment of the costs of sequestration.

By making use of a “friendly” sequestration the debtor avoids complying with the preliminary formalities for an application for voluntary surrender. Accordingly, creditors other than the “friendly” creditor do not get advance notice of the application (except employees, trade unions and the South African Revenue Service (see 2.3.2 in study unit 3 above)). Neither can they take notice of the debtor’s financial position, because there is no statement of affairs that lies for inspection. For these reasons there is a risk that a sequestration order may be made in circumstances where it would in fact not be in the interests of the group of creditors as a whole. That is why the courts pay special attention to the requirement of advantage to creditors when it appears that the applicant’s primary motivation in bringing the application is to assist the debtor.

Activity 5

With this activity, we intend to test your understanding of the **prescribed** case of *Epstein v Epstein* 1987 (4) SA 606 (C).

- (1) Determine the relationship between the applicant and the respondent.
- (2) Describe the unwelcome prospect that the applicant mentioned in the letter of 21 September 1986, and state the decision that the court reached on this point.
- (3) Identify the requirements for the granting of a provisional order of sequestration that were satisfied, and state the requirement that presented a problem to the court.
- (4) State the two ways in which the court should guard against the abuse of proceedings for “friendly sequestration”.
- (5) Describe the not very wholesome “carrot” which was dangled in front of the court.

Feedback

- (1) The applicant was the respondent’s mother. (See p 607 of the law report.)
- (2) The respondent said that he was desperate because several creditors had threatened to have him committed to prison by issuing court process against him for the nonpayment of his debts. (See p 607 of the law report.) The court summarised

aspects of section 65 of the Magistrates' Courts Act 32 of 1944. If a judgment debtor could show that he genuinely could not pay his debts because he lacked the means to do so, he would not be liable to imprisonment for contempt of court or for failure to pay his debts. The court rejected the argument that the respondent would inevitably be imprisoned if his estate were not sequestrated. He would not be imprisoned if he showed a genuine inability to pay his debts. Further, the risk of his imprisonment was not an indication that the sequestration of his estate would benefit his creditors. (See pp 611-612 of the law report.) **Note that the provisions of the Magistrates' Courts Act in terms of which a judgment debtor could be imprisoned if he failed to pay his judgment debt have since been declared unconstitutional and invalid by the Constitutional Court.** (See Hockly 7.3.)

- (3) The first two requirements for the granting of a provisional order of sequestration were satisfied. First, the applicant had filed papers which prima facie established a liquidated claim entitling her to apply for the sequestration of the respondent's estate. Secondly, the respondent's letter to her was an act of insolvency under section 8(g) of the Insolvency Act. The third requirement presented a problem to the court: whether on the facts there was reason to believe that it would be to the advantage of the creditors if the respondent's estate were sequestrated. (See pp 608-609 of the law report.)
- (4) The court quoted Holmes J in *R v Meer and others* 1957 (3) SA 614 (N), who laid down two ways of guarding against the abuse of proceedings for sequestration. First, the court should pay more attention to the element of advantage to creditors, particularly if the facts of the case suggest that it is a friendly sequestration based on section 8(g). Secondly, the court should refuse to grant repeated adjournments of the rule *nisi*, unless satisfied, on affidavit, that it would be to the advantage of creditors. (See p 611 of the law report.)
- (5) The respondent's father-in-law had undertaken to pay into the trust account of the applicant's attorneys the sum of R2 500 for distribution among the respondent's creditors after the sequestration costs had been met. The aim was to prevent the respondent's imprisonment. The sequestration costs being estimated at R1 500, a sum of R1 000 would then remain for distribution. (See p 608 of the law report.) It was held that in a friendly sequestration the court should be reluctant to approve a family member's offer of a small contribution as the "price" for the granting of a sequestration order. That procedure conflicted with the principles underlying the Act and the role which it assigned to the court. It amounted to confronting the court with a not very wholesome "carrot" to induce it to grant relief if it could not, and would not, otherwise do so. The court should resist such inappropriate cajolery. (See pp 612-613 of the law report.)

SELF-TEST QUESTIONS

- (1) Determine which requirements must be satisfied before the court may grant a final order for the compulsory sequestration of a debtor's estate.

(3)

- (2) Explain the concept “liquidated claim” and state three examples of such a claim. (7)
- (3) Describe the acts of insolvency in detail. (22)
- (4) State which property is covered by the term “disposable property” in relation to section 8(b) (failure to satisfy a judgment). (4)
- (5) A owes R40 000 to B and R30 000 to C, and both debts should have been paid a year ago. A’s sole asset of any value is a motorcar worth R80 000. A sells it to D for R50 000. On these facts, determine whether A has committed an act of insolvency, and give reasons for your answer. (8)
- (6) Compare section 8(c) with section 8(d) of the Insolvency Act by pointing out two differences between them. (2)
- (7) C publishes a notice of surrender of his estate. The statement of affairs which he lodges with the Master does not state that one of his creditors, Mr D, has a claim for R30 000. Advise C on the implications of these facts. (3)

NOTE TO STUDENTS ON THE WORD “ADVICE”

Note that the word “advice”, spelt with a “c”, is the noun form of this word, and that the word “advise”, spelt with an “s”, is the verb form of this word. The correct use of the two forms appears from the following two examples:

“You give advice to John.” In this statement, the word “advice” is the noun form, because what you give to John is advice.

“You advise John on the facts of the case.” In this statement, the word “advise” is the verb form, because what you do is to advise John.

So do not make the mistake, which is often made, of writing “You advice John on the facts of the case.” The mistake in this incorrect sentence is that the noun form of the word has been used, instead of the verb form. The correct sentence should therefore be: “You advise John on the facts of the case.”

- (8) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

The debtor commits an act of insolvency if he gives notice in writing of inability to pay any single one of his debts.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) Under section 12(1), the court must be satisfied that the applicant creditor has established a liquidated claim entitling him to apply in terms of section 9(1) for the sequestration of the debtor's estate, that the debtor has committed an act of insolvency or is insolvent, and that there is reason to believe that the sequestration of the estate would be to the advantage of the debtor's creditors.
- (2) A liquidated claim is a claim for money, the amount of which is fixed by agreement, judgment, or otherwise. The examples of such a claim given by Hockly include the following: a claim for the price of goods sold and delivered; a claim based on judgment for provisional sentence; and a claim for the return of the price paid under a sale which has been cancelled because of the seller's repudiation.
- (3) The acts of insolvency are the following:
 - (a) The debtor leaves the Republic or, being out of the Republic, remains absent from it, or departs from his dwelling or otherwise absents himself, with intent by doing so to evade or delay payment of his debts (s 8(a)).
 - (b) A court has given judgment against the debtor and he fails, upon the demand of the officer whose duty it is to execute the judgment, to satisfy it or to indicate to the officer disposable property sufficient to satisfy it, or it appears from the return made by the officer that he has not found sufficient disposable property to satisfy the judgment (s 8(b)).
 - (c) The debtor makes, or attempts to make, any disposition of any of his property which has, or would have, the effect of prejudicing his creditors or of preferring one creditor above another (s 8(c)).
 - (d) The debtor removes, or attempts to remove, any of his property with intent to prejudice his creditors or to prefer one creditor above another (s 8(d)).
 - (e) The debtor makes, or offers to make, any arrangement with any of his creditors for releasing him wholly or in part from his debts (s 8(e)).
 - (f) After publishing a notice of surrender of his estate which has not lapsed or been withdrawn in terms of sections 6 or 7, the debtor fails to comply with the requirements of section 4(3), or lodges a statement which is incorrect or incomplete in any material respect, or fails to apply for the acceptance of the surrender of his estate on the date mentioned in the notice of surrender as the date on which the application is to be made (s 8(f)).
 - (g) The debtor gives notice in writing to any one of his creditors that he is unable to pay any of his debts (s 8(g)).
 - (h) Being a trader, the debtor gives notice in the *Government Gazette* in terms of section 34(1) of his intention to transfer his business and is thereafter unable to pay all his debts (s 8(h)).

- (4) “Disposable property” in relation to section 8(b) means property that may be attached and sold in execution, even if situated in some other locality. It may be immovable, movable, or incorporeal. It does not include immovable property that has been mortgaged, **unless the applicant for compulsory sequestration is the first mortgagee.**
- (5) In terms of section 8(c), a debtor commits an act of insolvency if he makes, or attempts to make, a disposition of any of his property which has or would have the effect of prejudicing his creditors or of preferring one creditor above another. A’s sale of the motorcar falls within the definition of a “disposition” in section 2. In the examination of the **effect** of this disposition (not the intention with which it was made) it is relevant that more than one of A’s debts have fallen due and have not been paid. Either B or C would be entitled to apply for the compulsory sequestration of A’s estate, on the ground that the sale of the motorcar to D has prejudiced them. The applicant could allege that the sale of the motorcar for R50 000 (manifestly below its market value of R80 000) falls within the ambit of section 8(c) because it has rendered A insolvent. Previously, his assets (worth R80 000) exceeded his liabilities (R40 000 and R30 000), but now those liabilities exceed his assets (the R50 000 received for the motorcar). Therefore A has committed an act of insolvency in terms of section 8(c).
- (6) First, section 8(c) requires a disposition of property, but a mere removal of property is sufficient under section 8(d). Secondly, in section 8(c) the **effect** of the debtor’s disposition or attempted disposition is important, but in section 8(d) the **intention** of the debtor to prejudice his creditors or to prefer one of them above another is important.
- (7) Under section 8(f), a debtor commits an act of insolvency if he files a substantially incorrect or incomplete statement of affairs. The omission of a claim for R30 000 is sufficiently important to have influenced C’s creditors in deciding whether to oppose C’s application for voluntary surrender. It follows that C has committed an act of insolvency.
- (8) This statement is true. See Hockly 3.1.2(i)(g).

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 5

COMPULSORY SEQUESTRATION

In this study unit, we shall introduce you to the form and content of an application for the compulsory sequestration of a debtor's estate. We shall also guide you through the steps prior to, and after, the adjudication of the application.

After completing this study unit you should be able to

- describe systematically the form and content of the application for sequestration
- in an application for compulsory sequestration, explain the difference in onus of proof with respect to a provisional order and a final order for sequestration
- with reference to case law, explain what discretion the court has in respect of applications for compulsory sequestration
- name the instances where an appeal is possible in respect of a sequestration application
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

You must study Hockly chapter 3 from 3.2 to the end.

Also study the following:

***Amod v Khan* 1947 (2) SA 432 (N) (case [31] in Loubser)**

3.2.1 Form and content of application

You will notice that the applicant must mention the marital status of the debtor in his application. The reason for this is to prevent the granting of a sequestration order if the debtor is married in community of property and his or her spouse has not been joined as a second respondent. The court may still grant the order if the applicant creditor can satisfy the court that, despite reasonable steps, he could not determine the marital status of the debtor. Should it later turn out that the debtor was indeed married in community of property, the order will not be invalid merely because the other spouse was not before the court. The joint estate will therefore still be under sequestration.

In principle, it is not permissible to apply in one application for the sequestration of the estates of two different debtors. The main reason for this is that compliance with the requirements for a sequestration order has to be determined separately. Accordingly, it could be confusing for a creditor of only one of the debtors to concern himself with court papers in which information regarding the other debtor also appears.

In respect of a petition for the sequestration of an estate (see Hockly 3.2.1, 3.2.2), a new section 9(4A) is added by the Insolvency Second Amendment Act 69 of 2002. Section 9(4A) provides that when a petition is presented to the court, the petitioner must furnish a copy of the petition to every registered trade union which, as far as the petitioner can reasonably ascertain, represents any of the debtor's employees, and to the employees themselves, and to the South African Revenue Service. A copy must also be presented to the debtor, unless the court, in its discretion, dispenses with the furnishing of a copy where the court is satisfied that it would be in the interest of the debtor or of the creditors to dispense with it.

Activity 1

A new secretary has joined your attorney's firm and is helping you prepare the papers for an application for sequestration. In this case, Tenza had several creditors. One of them was Bonggi, to whom Tenza owed R5 000, being the price of goods sold and delivered. Bonggi later collided with Cat's car, causing R5 000 damage to it. Bonggi transferred his claim against Tenza to Cat. This agreement is reflected in a document in your client's file. Cat has taken judgment against Tenza, but the sheriff sent back a document stating that

- (1) he had explained to Tenza the nature and urgency of the warrant of execution
- (2) he had demanded payment, but Tenza had not satisfied the judgment
- (3) he had asked Tenza to indicate sufficient disposable property to satisfy the judgment, but Tenza had not done so
- (4) he could not find sufficient disposable property to satisfy the judgment, despite diligent search and inquiry

Cat now applies for the sequestration of Tenza's estate.

- (1) Describe the document which reflects the agreement between Bonggi and Cat.
- (2) State what the document which was sent back by the sheriff is called.
- (3) You have to prepare the court file concerning the application. Your secretary asks whether the original of the document, referred to in question (1) above, should be included in that file. State your answer, with reasons.

Feedback

- (1) This document is a deed of cession. (It reflects the agreement by which Bonggi, the cedent, transfers to Cat, the cessionary, a personal right which Bonggi has against

Tenza, the debtor. As a result of the agreement, the personal right passes out of the estate of Bongi into the estate of Cat.)

- (2) This document is a *nulla bona* return.
- (3) You tell your secretary not to include the original of the deed of cession in the court file. You do not need to file the original document in the court file, but may instead file a copy of it. But you must be able to produce the original for inspection if your opponent calls on you to do so (*Sugden and others v Beaconhurst Dairies (Pty) Ltd* 1963 (2) SA 174 (E) at 187). It would be advisable to keep the original deed of cession in your client's file, so that if any of the copies made for your advocate's brief, the attorneys acting for the debtor, or the court should go missing, then further copies may be made from your original. At the hearing of the application you should attend court with your client's file, in case the original documents are required by the court.

3.2.3 Provisional sequestration

Section 11 of the Insolvency Act, in respect of the service of a rule *nisi* upon the debtor, has been replaced by the Insolvency Second Amendment Act 2002. Section 11 now provides that if the court sequesters the estate of a debtor provisionally, it must simultaneously grant a rule *nisi* calling upon the debtor upon a day mentioned in the rule to appear and to show cause why his or her estate should not be sequestered finally. A copy of the rule *nisi* must be served on any trade union referred to above (see Hockly 3.2.1, 3.2.2), the debtor's employees and the South African Revenue Service.

3.3 Court's discretion

The fact that the court still has a discretion to grant or to refuse a final order, even if the applicant has proved all the requirements of section 12, is well illustrated by the **prescribed** case of *Amod v Khan* 1947 (2) SA 432 (N). In that case, the debtor had a claim against the applicant's son which was larger than the claim of the applicant against the debtor. The sequestration of the debtor's estate would have meant that he himself (the debtor) would no longer have been able to enforce his claim against the son. In the circumstances, sequestration would not have been to the advantage of the creditors (of the debtor) as a group. The applicant's correct remedy was to take out a warrant for the execution of his judgment against the debtor, and then have the debtor's claim against the applicant's son attached in payment of the judgment debt. The court went further in giving reasons for its judgment. Even if it were assumed that sequestration would have been to the advantage of the creditors, it was clear that the applicant had brought the application with the exclusive aim of preventing the debtor from enforcing his claim against the applicant's son. That amounted to an abuse of the court process, and for that reason the court should in any event exercise its discretion against the applicant.

3.5 Unwarranted or vexatious proceedings

An application for compulsory sequestration is malicious if the applicant is not motivated by the best interests of the creditors as a group, but by enmity towards the debtor. An application is vexatious if the applicant clearly has no grounds for a sequestration order.

Section 15 of the Insolvency Act 1936 is replaced by the Insolvency Second Amendment Act 2002. Section 15 now provides for compensation to a debtor if a petition for the sequestration of his or her estate is **an abuse of the court's procedure** or malicious or vexatious. The phrase "**an abuse of the court's procedure**" has thus been added to section 15.

3.6 Setting aside sequestration order

Note that under certain circumstances one can appeal against a final order of compulsory sequestration, or an order setting aside a provisional order of sequestration.

SELF-TEST QUESTIONS

- (1) Briefly state, in point form, the necessary information and averments which should appear in the founding affidavit of an application for compulsory sequestration. (16)
- (2) Give a systematic explanation of the steps which must be taken before the adjudication of an application for compulsory sequestration. (7)
- (3) Identify and list the papers that must be before the court where an application for a provisional order of sequestration is being heard. (6)
- (4) Identify and list which papers, apart from those before the court when the rule *nisi* was made, must be before the court on the return day of a rule *nisi* after provisional sequestration has been ordered. (4)
- (5) In an application for the sequestration of D's estate, the founding affidavit by applicant C states the full name, date of birth and identity number of D. As regards D's marital status, the affidavit merely states that D's marital status is unknown. In a well-reasoned argument, state whether the court would be entitled to grant C's application for the sequestration of D's estate. (8)
- (6) Explain why a creditor may not generally join two debtors in one application for the sequestration of their respective estates, even if they are jointly and severally liable to the creditor. (3)
- (7) When the court is about to grant a rule *nisi* in connection with the provisional sequestration of F's estate, it appears that F has not been at his home or his shop in Bloemfontein for three months. What arrangements are possible for the service of the rule *nisi*? (6)

- (8) A and B are the creditors of C. A has taken judgment against C for R500 and has taken out a writ of execution, and the sheriff has made a *nulla bona* return. A now seeks an order for the sequestration of C's estate. It also appears that before A took judgment against him C's sole asset of any value was a claim for R1 000 against A's friend, D. The claim had previously been disputed, but recently a court decided in C's favour with respect to the claim. Advise C on a possible method of combatting the application for sequestration.
- (9) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

The court may exercise its discretion to refuse to grant a sequestration order if the debtor has instituted an action for damages against the creditor which, if successful, will wipe out the creditor's claim.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) The founding affidavit in an application for compulsory sequestration should contain the following:
- (a) the full name, status, occupation and address of the sequestrating creditor
 - (b) information confirming that the creditor has *locus standi* to apply
 - (c) information supporting the authority of any agent, company director or official to bring the application
 - (d) the full name, date of birth, identity number and marital status of the debtor (if the debtor is married the full name, date of birth and identity number of his spouse must also be supplied)
 - (e) information showing that the court has jurisdiction to hear the application
 - (f) the amount, cause and nature of the claim
 - (g) a statement on whether the claim is secured or not and, if it is, the nature and value of the security
 - (h) the act (or acts) of insolvency allegedly committed by the debtor and/or a statement to the effect that he is factually insolvent
 - (i) an averment that sequestration will be to the advantage of creditors and an explanation why this will be so
 - (j) any other relevant facts which may influence the discretion of the court in granting or refusing a sequestration order

- (k) a statement that security will be furnished to the Master and that his certificate will be obtained as required (if already obtained, this certificate should be attached to the affidavit)
 - (l) a statement that a copy of the papers will be lodged with the Master with a view to obtaining his report in terms of section 9(4)
 - (m) a statement confirming that copies of the application will be furnished to interested parties as required by s 9(4A)(a), and that an affidavit will be filed before or during the hearing, setting out the manner in which the section was complied with
- (2) The steps are as follows:
- (a) The creditor must lodge security for costs.
 - (b) In the Western Cape High Court, Cape Town (which was formerly known as the Cape Provincial Division), the creditor's attorney must conduct the necessary search of the Master's Office records regarding the sequestration of the debtor's estate.
 - (c) The applicant must file the application papers at court.
 - (d) The applicant must lodge a copy of the notice of motion and supporting affidavit(s) with the Master or his designated officer, so that the Master's report may be drawn up and lodged.
 - (e) The application for provisional sequestration must be served on the debtor. To this general rule there are exceptions in Natal, Gauteng, and the Western Cape regarding a *nulla bona* return or independent documentary evidence supporting the application.
- (3) The following papers must be before the court:
- (a) the notice of motion (including a draft of the desired provisional order of sequestration) and the founding affidavit(s)
 - (b) the Master's certificate that security has been given
 - (c) the affidavit of the search made by the sequestrating creditor's attorney (ie, in the Western Cape)
 - (d) the Master's report or, if none, proof of service of the papers on him
 - (e) the sequestrating creditor's replying affidavit (if any) responding to the Master's report

- (f) an affidavit by the person who furnished copies of the application to the debtor and other interested parties in compliance with s 9(4A)(a), setting out the manner in which this was done
- (4) Apart from the papers mentioned in (3) above, the following must also be before the court:
- (a) the sheriff's return of service of the rule *nisi*
 - (b) any opposing affidavits of the debtor and/or other creditors
 - (c) the replying affidavit of the applicant (if any)
 - (d) any affidavit by the provisional trustee
- (5) In principle, an application to sequester the joint estate of spouses married in community of property must be made against both spouses (s 17(4) of the Matrimonial Property Act). This requirement of section 17(4) is peremptory, and so C must ascertain D's marital status before applying for sequestration. However, the proviso to section 17(4) states that the court may not dismiss the application for sequestration if the creditor satisfies the court that he took reasonable steps but could not establish whether D was married in community of property, or what the name and address of D's spouse were. In the present case, C makes the bald statement that D's marital status is unknown. C has not stated any reasonable steps that he took to ascertain D's marital status. Because the proviso to section 17(4) does not apply, C has failed to comply with the general provision of section 17(4), and therefore the court may not grant the application.
- (6) The main reason that the creditor may not join the debtors in one application is that it must be independently established whether the requirements for a sequestration order have been met. It may therefore be confusing for a creditor of only one of the debtors to concern himself with court papers containing information about the other debtors as well.
- (7) Because F has been absent from his usual place of residence and from his business in Bloemfontein for more than 21 days the court may direct that the rule *nisi* will be sufficiently served if a copy of it is attached to the door of the courthouse and published in the *Government Gazette* (s 11(2)). Alternatively, the court may direct some other form of service. (An example of such other form of service is publication of the rule *nisi* in a newspaper.)
- (8) The facts bear some similarities to those of *Amod v Khan* 1947 (2) SA 432 (N). Just as in that case the applicant creditor's claim was less than the debtor's claim against the applicant's son, so here A's claim for R500 against C is less than C's claim for R1 000 against A's friend, D. The sequestration of C's estate would prevent C from enforcing that claim against D. Because C has no other assets of value and there are insufficient assets to cover the probable sequestration costs, sequestration would not be to the advantage of the creditors (A and B, viewed as a group). The proper and less expensive alternative would have been for A to have the writ of execution reissued, have C's claim against D (which is no longer the subject of a dispute)

attached, and recover payment from the proceeds of this asset. Any balance remaining would then pass to C. Instead, A, through his oppressive choice of sequestration proceedings, seems to be abusing the sequestration process simply to protect his friend, D, from C's claim.

- (9) This statement is true. See Hockly 3.3.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 6

THE LEGAL POSITION OF THE INSOLVENT

In this study unit, we introduce you to the consequences that the sequestration of a person's estate may have for an insolvent person such as Tenza. Sequestration affects a person's status in the sense that it curtails his or her capacity to enter into contracts, to earn a living, to litigate, and to hold office.

After completing this study unit, you should be able to

- distinguish between contracts that are prohibited and contracts that are not prohibited
- give examples of contractual rights which the insolvent may enforce for his own benefit
- describe the consequences of concluding a prohibited contract
- explain the meaning of the terms "general dealer" and "manufacturer" in the context of insolvency law, and understand why these words are important and how they may relate to case studies regarding the insolvent person's right to earn a living
- list and discuss the proceedings which the insolvent may personally institute or defend
- analyse the instances in which an insolvent may be required to furnish security, and apply them to case studies
- explain which offices the insolvent may not hold, and why he or she may not hold these offices
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

Study Hockly chapter 4.

4.1.1 Prohibited contracts

Generally speaking, insolvency does not deprive the insolvent debtor from entering into contracts, but merely limits his or her capacity to do so by prohibiting the insolvent from entering into **some** contracts.

Activity 1

- (1) Distinguish which two types of contract will be invalid (because they are prohibited contracts) in terms of section 23(2).
- (2) Complete the following sentence:

The determination which the Master may make in terms of section 23(5) refers to, which in the opinion of the Master is not required for

Feedback

- (1) Read Hockly 4.1.1 again. The answer is contained in the first two sentences of the first paragraph.
- (2) You will be able to complete the sentence if you study Hockly 4.1.1.

With regard to contracts which the insolvent may not conclude, note section 23(6) of the Act as well. Under this section, no cession of amounts earned by the insolvent after the sequestration of his estate, whether made before or after the sequestration, is of any effect as long as his estate is under sequestration. The reason for this prohibition is to prevent the determination which the Master is empowered to make in terms of section 23(5) from being reduced to an empty shell.

Activity 2

- (1) Explain why a cession of income which the insolvent earns is simply not permitted in terms of section 23(6), but another contract may be concluded with the consent of the trustee.
- (2) Write down the legal principle as given in *Mervis Brothers (Pty) Ltd v Hanekom* 1963 (2) SA 125 (T).

Feedback

- (1) If the insolvent could simply cede his right to amounts earned by him, the Master's power to make a determination in terms of section 23(5) would in effect be eliminated.
- (2) The legal principle is set out in Hockly 4.1.1.

4.1.2 Effect of contract which is not prohibited

Where the insolvent enters into a contract that is not prohibited he may not enforce performance in his favour unless the Insolvency Act (or some other statute) specifically gives him the right to do so.

Activity 3

- (1) Although A, an insolvent medical practitioner, may enter into a partnership contract with P with the consent of the trustee, A may not enforce his rights in terms of the partnership contract. However, S, an insolvent actor, may himself claim compensation in terms of an employment contract. Explain this anomaly with reference to *De Polo and another v Dreyer and others* 1991 (2) SA 164 (W) and *Ex parte Van Rensburg* 1946 OPD 64.
- (2) List the amounts which an insolvent may collect for her own benefit in terms of sections 23(7)-(9).

Feedback

- (1) According to *De Polo v Dreyer* and *Ex parte Van Rensburg*, an insolvent may enforce only those contractual rights which are specifically provided for in the Act – for example, payment for work done after sequestration. The fact that an insolvent is empowered to enter into a partnership contract with the trustee's consent does not mean that he may in his own name recover an amount owing to him in terms of the partnership contract.
- (2) Ensure that you list all three instances. See also Hockly 4.3.1.

4.1.3 Effect of prohibited contract

Note that if the insolvent enters into a prohibited contract the contract is voidable at the option of the trustee – it is not void.

Activity 4

- (1) What is the difference between a **void** and a **voidable** contract?
- (2) Explain the position of innocent third parties who concluded a contract with the insolvent for the alienation of property in each of the following circumstances:
 - (a) The property formed part of the insolvent estate at the time of sequestration.
 - (b) The property was acquired by the insolvent after sequestration.
 - (c) The property was acquired by the insolvent in substitution for an asset which formed part of the insolvent estate at the time of sequestration.

Feedback

- (1) A **void** contract simply has **no legal force**, but a **voidable** contract **has legal force until it is set aside**.
- (2) (a) and (b): The answer is contained in section 24(1) of the Insolvency Act and in Hockly 4.1.3.

(c): See *Wessels v De Klerk and another* 1960 (4) SA 310 (T).

4.2 Earning a livelihood

The insolvent is allowed to follow any profession or occupation or enter into any employment. But to hold **some** positions, he needs the consent of his **trustee**. And sometimes he needs permission from **the court**, as will be discussed in Hockly 4.4 below.

Note that a farmer is not a “trader” for the purposes of the Insolvency Act. He is therefore also not a “general dealer” or a “manufacturer” for the purposes of section 23(3).

Activity 5

- (1) Compile a list of the types of activity included in those of a “trader” in terms of the definition in section 2 of the Insolvency Act.
- (2) State in each case whether an insolvent may engage in the following activities without the trustee’s consent. Give reasons for your answer.
 - (a) selling live chickens and honey at a farm stall
 - (b) farming
 - (c) working as a boarding-house keeper
 - (d) working as a building contractor
 - (e) working in a café
 - (f) working as a caterer
- (3) Argue, with reasons, why you think an insolvent is prohibited from working as a general dealer or a manufacturer or from having an interest in these activities without the consent of the trustee.

Feedback

- (1) Ensure that you list all the activities which are described. Look at this list again after studying your answer in (2) below.
- (2)
 - (a) Yes. If these items are products of his farming, he may sell them.
 - (b) Yes. See section 2.
 - (c) Yes. Here, too, the insolvent is a trader, but not a general dealer or a manufacturer.
 - (d) Yes. See the answer to (c).
 - (e) No. A café sells a variety of goods and could be regarded as a general dealer – see *S v Van der Merwe* 1980 (3) SA 406 (NC).
 - (f) Yes. See the answer to (c).
- (3) There is a possibility of prejudice to the public. But the differentiation is anomalous, because a dressmaker cannot, for example, really cause prejudice to anyone.

4.3.1 Proceedings which may be brought/defended personally by insolvent

Insolvency does not necessarily preclude (prevent) an insolvent debtor from being a party to legal proceedings.

Activity 6

- (1) Make a list of proceedings which may be instituted by the insolvent personally.
- (2) In which instances may the insolvent interfere with the administration of his insolvent estate?

Feedback

- (1) Make sure that you have listed all six instances in which the insolvent may personally institute legal proceedings. The six instances are mentioned in Hockly 4.3.1.
- (2) Only if there is an irregularity or the bona fides of the trustee or the creditors is under suspicion. Look again at the principle in *Kruger v Symington en andere* 1958 (2) SA 128 (O), mentioned in Hockly 4.3.1.

4.3.2 Security for costs

An insolvent who enters into legal proceedings may be obliged to give security for the costs of the action.

Activity 7

Complete the following table. Indicate in each instance whether the insolvent has to lodge security or not. Under the heading "Factors", indicate which factors the High Court takes into account.

	Magistrate's court	High Court	Factors
Case flows from the Insolvency Act			
Case does not flow from the Insolvency Act			

Feedback

Your table could look as follows:

	Magistrate's court	High Court	Factors
Case flows from the Insolvency Act	Plaintiff compelled if defendant claims security	Cannot claim security	May claim security if the action will probably not succeed
Case does not flow from the Insolvency Act	Plaintiff compelled if defendant requires security	Plaintiff not compelled to lodge security	May claim security if action is reckless or vexatious

4.3.3 Entitlement to costs

Judgment costs in favour of the insolvent belong to him personally: these costs do not form part of his insolvent estate.

Activity 8

Distinguish the two situations in which an order for costs will accrue to the insolvent personally.

Feedback

The two situations are set out in the discussion of *Schoeman v Thompson* 1927 WLD 298 and *Ecker v Dean* 1940 AD 206 in Hockly 4.3.3.

4.4 Holding office

Note that there are **some** positions which the insolvent is **absolutely prevented** from holding, and **other** positions for which the **insolvent needs the court's consent**. The insolvent is absolutely prevented from being the trustee of an insolvent estate. He or she is also absolutely prohibited from being a member of the National Assembly, the National Council of Provinces, or a provincial legislature. Nobody, not even a court, can give the insolvent permission to occupy these positions.

By contrast, the court is authorised to give the insolvent permission to be a company director or to take part in the management of a close corporation. Note carefully that the insolvent needs the **court's permission** to take part in the **management** of a close corporation, but that he or she may be a **member** of a close corporation **without needing the court's permission**.

For extra information, we should explain that the National Assembly and the National Council of Provinces are the two chambers of the South African Parliament, which passes legislation for the whole Republic of South Africa. If interested, you can find further information about the Parliament of South Africa on its website at <http://www.parliament.gov.za/live/index.php>. South Africa also has nine provinces (Limpopo, Mpumalanga, Northwest, Gauteng, Free State, KwaZulu-Natal, Eastern Cape, and Western Cape), and each province has its own provincial legislature to pass legislation for that particular province. To read about one example of a provincial legislature, you may like to read the information on the website of the Gauteng Legislature at <http://www.gautengleg.gov.za/default.aspx>.

By now it should be clear to you that you should not confuse the National Council of Provinces with a provincial legislature. The National Council of Provinces is a chamber of the South African Parliament, and a provincial legislature is a legislature for one of the nine provinces. The two kinds of legislative bodies have different authority, powers, and functions.

Activity 9

The following questions do not have any right or wrong answer. They are posed merely to encourage you to think critically about the policy considerations upon which the disqualifications for holding some offices are based.

- (1) Argue, giving reasons, why an insolvent is prohibited from holding some offices.
- (2) Can you find a common denominator among all the different offices which an insolvent may not hold? (In other words, do they all have something in common?)
- (3) Do you think it is fair to prohibit a person from being, for example, a member of the National Assembly if he or she is insolvent?

Feedback

An insolvent is prohibited from holding some offices if there is a possibility of prejudice to the public interest (eg, the National Assembly), if a great amount of trust and responsibility is required (eg, a trustee of an insolvent estate), or if the possibility of dishonest business practices exists (eg, running a close corporation). The common denominators in these offices are honesty and trust. It is not always fair to suspect a person who is insolvent of dishonesty. Sometimes there is an accumulation of circumstances over which the debtor had no control which led to his insolvency. But very high expectations are placed on members of the National Assembly, and it is therefore reasonable to prohibit a person who is insolvent from serving as a member.

SELF-TEST QUESTIONS

- (1) Tenza, an insolvent, gives private music lessons to T. (Shortly before his estate was sequestrated, Tenza took music classes in the evenings at the Noise Academy and qualified as a part-time music teacher). With the consent of the trustee of the insolvent estate, Tenza entered into a partnership agreement with S. The partnership sells cosmetics. Tenza also entered into an agreement with L, one of his clients, that L would buy his (Tenza's) spa bath for R3 000. L is unaware that Tenza is insolvent. T is in arrears with two months of her tuition fees for the music lessons. Tenza also has not received his share of the profits in the partnership as agreed upon in the partnership agreement.

Tenza is of the opinion that his trustee wishes to sell his residence for far too little. Tenza very much wishes to stand as a candidate in the coming provincial elections, and to act for the KISS party. His trustee is of the opinion that he should not begin his political career at this stage.

Tenza approaches you for legal advice.

- (a) He requests that you recover the outstanding tuition fees and his share of the partnership profits due to him. May he collect these debts for his personal benefit? (8)
- (b) Explain to Tenza whether he must inform his trustee that he (Tenza) has sold his spa bath to L. (8)

- (c) Argue, giving reasons, whether it would make a difference to your answer in (b) above if Tenza had received the spa bath as a birthday present after the date of sequestration of his estate. (5)
- (d) Explain whether Tenza may take any steps to prevent the sale of his residence. (8)
- (e) Explain whether Tenza's trustee may interfere with Tenza's intended political career. (2)
- (2) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

While Sam is under sequestration she breaks Tim's jaw in a fist-fight and so Sam, not the trustee of Sam's insolvent estate, may now be sued by Tim for delictual damages. (2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) (a) An insolvent may exercise his or her trade or profession (s 23(3) of the Insolvency Act). Tenza may therefore give music lessons. The insolvent may for his or her own benefit recover remuneration for professional services which he rendered after sequestration (s 23(9)). Tenza may therefore give instructions in his own name for the recovery of the arrear tuition fees.
- A contract concluded by an insolvent is valid and binding on the parties. But according to *De Polo and another v Dreyer and others* 1991 (2) SA 164 (W) the insolvent may claim fulfilment of the contract only if the Insolvency Act or another Act specifically empowers him or her to do so. Because there are no statutory provisions that grant it, Tenza has the right to claim outstanding partnership profits for his own personal benefit, and he may not give instructions for the recovery of this debt.
- (b) An insolvent may not conclude a contract for the alienation of assets belonging to the insolvent estate (s 23(2)). If the insolvent concluded a prohibited contract it will be voidable at the option of the trustee. The trustee may decide that the contract is binding on both parties (by not setting it aside), or he may withdraw from the contract. If the trustee sets the contract aside he may recover the performance already rendered by the insolvent, but he also has to return any benefit that the insolvent obtained from the contract. The contract that Tenza concluded with L is therefore voidable. Tenza's trustee may therefore either uphold the contract or withdraw from the contract and reclaim the spa bath. Tenza's trustee will then have to return the R5 000 that L paid for the spa bath.
- (c) Yes, it would make a difference to the answer. Section 24(1) governs the situation where an insolvent purports to alienate, for valuable consideration,

without the consent of the trustee of his or her estate, any property which he or she acquired after the sequestration of his or her estate. If the other person proves that he or she was not aware and had no reason whatsoever to suspect that the estate of the insolvent was under sequestration, the alienation will nevertheless be valid. L may therefore retain the spa bath if she can prove that she was not aware that Tenza was insolvent and that she purchased the spa bath for value.

- (d) Tenza, the insolvent, retains a reversionary interest in his estate. The insolvent may therefore institute proceedings to ensure that the estate is properly administered. But an insolvent may institute proceedings regarding the administration of the estate only if an irregularity took place or a lack of bona fides on the part of the trustee or the creditors is questionable. In *Kruger v Symington en andere* 1958 (2) SA 128 (O) it was decided that the mere fact that the creditors of the insolvent estate decided to sell an asset in the estate for a price less than its real value (a fact of which they were not aware at that stage) is not a sufficient ground to set aside the decision and the sale.

Because Tenza therefore has a reversionary interest in the proper administration of his estate, in principle he may institute legal proceedings to prevent the sale of his residence. But he may stop the sale only if he can indicate that some irregularity took place or that his trustee is not acting in good faith. Tenza will therefore not succeed in legal proceedings aimed at stopping the sale merely because he thinks that the price is too low.

In case you are wondering what the phrase “reversionary interest” means in the present context we should explain that it is a right which returns to the holder of the right (in this instance, the insolvent) after the expiry of the period during which the estate is under sequestration. So the right of the insolvent to own and to control his or her assets returns (comes back to him) from the trustee if the sequestration order is set aside. Note that in this context the word “interest” does not mean interest in the sense of money paid for the use of money lent, as in the sense of simple interest or compound interest.

- (e) An unrehabilitated insolvent may not be a member of the provincial legislature (s 106(1)(c) of the Constitution of the Republic of South Africa Act 1996). Tenza’s trustee’s opinion that Tenza cannot now begin his political career is thus correct.
- (2) This statement is true. Sam’s act of breaking Tim’s jaw is an example of a delict, and so Sam, as an insolvent, may on this ground be sued in her own name and without reference to the trustee of her insolvent estate. See Hockly 4.3.1. These damages are recoverable from the separate estate that Sam is entitled to build up during the period in which she is under sequestration (see Hockly 1.3.1 and 5.5).

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 7

VESTING OF THE ASSETS OF THE INSOLVENT

In this study unit, we introduce you to one of the further consequences of the sequestration of a debtor's estate, namely the divesting of the insolvent's estate. In other words, the Master, and ultimately the trustee, takes control of virtually all the property of the insolvent debtor so that the trustee can sell it and distribute the proceeds among the creditors.

After completing this study unit you should be able to

- distinguish between those assets which fall into the insolvent estate and which are therefore at the disposal of the creditors, and those assets which do not form part of the estate and which therefore remain the property of the debtor
- establish the field of application of section 63 of the Long-term Insurance Act 52 of 1998 and apply the provisions of this section to a case study or problem
- distinguish and discuss the exceptions where the insolvent can validly dispose of goods forming part of the insolvent estate
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

Study Hockly chapter 5.

Also study the following:

Vorster v Steyn NO en andere 1981 (2) SA 831 (O) (case [45] in Loubser)

Background information about the South African law on the matrimonial property regime

For the purposes of our case study involving Tenza, assume that Tenza married Mpho by antenuptial contract (out of community of property) three years before his estate was sequestrated.

At this point, we need to give you some background explanation of the South African law concerning the effects of marriage upon the property of the spouses after they are married. (The technical legal term for this area of law is the "matrimonial property regime".) The basic

distinction to bear in mind is between marriage **in community of property** and marriage **out of community of property**.

Marriage in community of property

First, we shall discuss the system of marriage **in community of property**, which is the basic rule in South African common law. In other words, marriage in community of property is the general position regarding the spouses' matrimonial property regime if the spouses do not make alternative arrangements in this regard. Before the spouses marry each other they each have a separate estate consisting of assets and liabilities. Once the spouses marry each other in community of property, however, each spouse no longer has a separate estate consisting of assets and liabilities. Instead, the assets and the liabilities of both the spouses fall into a new estate called the **joint estate** of the spouses. So, if one of the spouses is declared insolvent, then, because there is only one joint estate, the result is that the other spouse automatically becomes insolvent too, and both spouses are under sequestration.

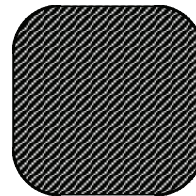
We can illustrate the principles in the previous paragraph by means of the following diagram:

BEFORE MARRIAGE

Sam's separate estate
(Sam's assets and liabilities)

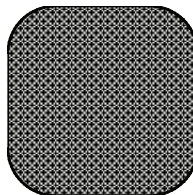


Tina's separate estate
(Tina's assets and liabilities)



Marriage **IN community of property**

The **joint estate** of Sam and Tina
(the assets and liabilities of Sam **AND** the assets and liabilities of Tina)



Marriage out of community of property

Now we shall discuss the **other** system of the marital property regime – marriage **out of community of property**. Before the spouses marry each other, they each have a separate estate, consisting of assets and liabilities. And after the spouses marry each other out of community of property, each spouse **continues to have a separate estate** consisting of assets and liabilities. There is no joint estate of the spouses. In order to marry out of community of property, the spouses must enter into an antenuptial contract excluding the community of property (and thus excluding the general rule of South African law concerning the matrimonial property regime).

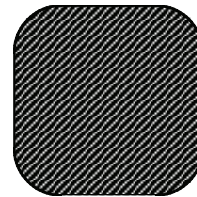
We can illustrate the principles in the previous paragraph by means of a diagram:

BEFORE MARRIAGE

Tenza's separate estate
(Tenza's assets & liabilities)



Mpho's separate estate
(Mpho's assets & liabilities)

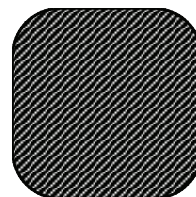


Marriage **OUT OF** community of property (by means of antenuptial contract excluding community of property)

Tenza's separate estate
(Tenza's assets & liabilities)



Mpho's separate estate
(Mpho's assets & liabilities)



5.1 Vesting of estate in trustee

You will note that Hockly is of the opinion that the assets in the insolvent estate will again vest in the former insolvent if he is rehabilitated in terms of section 124(3) of the Insolvency

Act. In this instance, the insolvent is rehabilitated on the grounds that no claims have been proved against the estate, that the insolvent has not been convicted of any offence with regard to his insolvency, and that his estate has not been sequestered before (see Hockly 19.2.1(iii) concerning rehabilitation). The result of a rehabilitation order made in terms of section 124(3) is that the insolvent is automatically reinvested with the assets of his estate (s 129(2)). But in all other instances of rehabilitation this consequence does not follow: those assets which vested in the trustee at the time of rehabilitation remain vested in him, to be realised for the benefit of the creditors (see the proviso to s 25(1) and s 129(3)(c)).

Activity 1

Summarise the circumstances in which the former insolvent is reinvested with the assets of the insolvent estate.

Feedback

Ensure that your summary includes the requirements which are to be met in terms of section 124(3).

5.2 Property which falls into estate

Study Hockly 5.2 and the **prescribed** decision in *Vorster v Steyn NO en andere* 1981 (2) SA 831 (O), having regard to the following two aspects. The first aspect deals with what happens to property inherited by the insolvent while his or her estate is under sequestration and he or she is not yet rehabilitated. The second aspect deals with the possibility of a declaratory order relating to property which has been inherited (see Hockly 19.4 concerning the latter aspect).

The reasoning and decision in *Badenhorst v Bekker NO en andere* 1994 (2) SA 155 (N) were approved by the Supreme Court of Appeal in *Du Plessis v Pienaar NO and others* 2003 (1) SA 671 (SCA). The Supreme Court of Appeal held that a debtor, not the estate of the debtor, incurs the debt. So where spouses are married in community of property their creditors may recover debts from both of them: not only from each spouse's undivided interest in the joint estate, but also from his or her separate estate outside the joint estate. Once the joint estate is sequestered both spouses are insolvent, and property owned by each of them (including separate property) becomes available to the creditors.

Note that the effect of the decisions in *Vorster* and *Badenhorst* must now be considered in the light of the decision in *Wessels NO v De Jager en 'n ander NNO* 2000 (4) SA 924 (SCA), as summarised in Hockly 5.2.

Activity 2

- (1) Explain what the position is in the following instances:
 - (a) An insolvent is in possession of an asset which is claimed by the trustee.
 - (b) A person became a creditor after the sequestration of the estate and alleges that an asset does not form part of the insolvent estate.
- (2) Summarise the principles laid down in *Vorster* and *Badenhorst* and *Wessels*.

Feedback

- (1) Study section 24(2) of the Insolvency Act. Such property is deemed to be part of the insolvent estate until the contrary is proved.
- (2) See Hockly 5.2 and study section 24(2) of the Insolvency Act. Such property is deemed not to belong to the insolvent estate unless the contrary is proved.

5.3.8 Insurance policies

5.3.8(i) Policies covering liability to third parties

It is important to note that the effect of section 156 of the Insolvency Act is that the third party has a claim directly against the liability insurer. The third party therefore does not have to rely on a mere concurrent claim against the insolvent estate in so far as he may claim the damages from the insurer. It is also important to note that the third party who has the right to claim directly from the insurer in terms of section 156 is exposed to all the same defences which, in the absence of section 156, the insurer could have raised against the contracting party (the insolvent). This principle may be illustrated with the decision in *Canadian Superior Oil Ltd v Concord Insurance Co Ltd (formerly INA Insurance Co Ltd)* 1992 (4) SA 263 (W). There the insolvent incurred liability towards the plaintiff. The plaintiff wished to claim the damages directly from the insurer in terms of section 156. The insurance contract between the insolvent and the insurer, however, stated that the insurer would be liable to compensate the insured only for moneys already paid by the insured (the insolvent). Because the insolvent (as a result of the intervening insolvency) had not made any payments towards his liability the insurer was therefore also not obliged to make any payments to the insolvent. The same defence could therefore be raised against the third party (the plaintiff).

Note that Hockly 5.3.8(i) and Hockly 5.3.8(ii) deal with different situations. Hockly 5.3.8(i) helps a third party to claim directly against the insurer after the defendant has been declared insolvent and is under sequestration. By contrast, Hockly 5.3.8(ii), as we shall see, provides limited protection to the insolvent or the insolvent's spouse in relation to certain life insurance and other similar policies. Do not therefore make the mistake of applying section 156 to a question about the possible protection of life insurance policies from inclusion in the insolvent estate.

5.3.8(ii) Life policies etc

We wish to point out two mistakes often made by students in relation to section 63 of the Long-term Insurance Act 1998. First, do not make the mistake of thinking that if the relevant policy is worth less than R50 000 it will therefore not fall into the insolvent estate. If the policy has not existed for the required three years before sequestration that policy will fall into the insolvent estate, even if it is worth, for example, R1 000.

Secondly, do not make the mistake of thinking that, in order for the insolvent (the life insured) to receive the protection of section 63(1) of the Long-term Insurance Act, the policy must be worth more than R50 000. If the policy is worth, for example, R10 000 and has existed for 15 years, the full amount of R10 000 will be protected by section 63 from falling into the insolvent estate.

5.3.10 Trust property/funds

Assets in a trust will not usually form part of the personal estate of the trust trustee if that trustee's personal estate is sequestrated. Assets in a trust are therefore protected assets.

Activity 3

In some instances, trust property and funds do not form part of the insolvent estate of the trustee or other person controlling it. Make a list of the instances mentioned by Hockly.

Feedback

Remember to include moneys held in a sheriff's trust account in your list.

5.4 Disposal of estate property by insolvent

In Hockly 5.4, mention is made of one exception to the rule that an insolvent may not deal with property falling within the insolvent estate. In fact, there is another exception mentioned in section 24(1) of the Insolvency Act (see Hockly 4.1.3).

Note that section 25(3) of the Insolvency Act does not apply if a *caveat* entered on the title deeds of immovable property was incorrectly removed by the Registrar of Deeds. Section 25(3) comes into effect only when a *caveat* lapses by reason of the passage of time.

Activity 4

In which instances will the countervalue be insufficient in terms of section 25(4) of the Insolvency Act? Give an example of such an insufficient countervalue.

Feedback

No countervalue will be deemed to have been received if the counter-performance was, for example, disproportionate to the asset or benefit received. An example would be where a farm valued at R200 000 is bought for R50 000.

SELF-TEST QUESTIONS

- (1) Tenza and Mpho are married out of community of property and of profit and loss, and their antenuptial contract does not exclude the accrual system. A few years later Tenza's estate is sequestrated. It appears that Mpho's estate has increased by R100 000 since the conclusion of the marriage. Tenza's estate has obviously not increased at all, because the estate is insolvent.

Answer the following questions:

- (a) Explain whether the trustee of Tenza's insolvent estate has any claim to half the accrual of Mpho's estate. (2)

- (b) Would your answer differ in (a) above should Mpho die before Tenza is rehabilitated?

(2)

- (2) Tenza is married to Mpho out of community of property and of profit and loss. Tenza is an avid collector of antique furniture and possesses various exceptionally valuable pieces. Tenza's estate is sequestrated. Explain whether the antique furniture forms part of Tenza's insolvent estate.

(5)

- (3) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

Boris Green, the trustee of the duly constituted Smith Family Trust, buys a car with moneys deposited in that duly constituted trust fund, and when Boris's personal estate is later sequestrated that car falls into his insolvent estate.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) (a) The trustee of Tenza's insolvent estate does not have any claim to half the accrual in Mpho's estate, because the marriage has not yet been dissolved.

(b) Should Mpho die (and the marriage therefore dissolve) before Tenza is rehabilitated, Tenza's right to the accrual in Mpho's estate will form part of Tenza's insolvent estate and it could be enforced by the trustee for the benefit of the creditors of Tenza.

- (2) In terms of section 20(1), sequestration has the effect of divesting the insolvent of his estate and vesting it in the Master and thereafter in the trustee on his appointment. The estate includes all property belonging to the insolvent at the date of sequestration and property acquired by him during sequestration, except property which is excluded by section 23. Household goods and other means of subsistence are excluded, but only in so far as provided for by the Master or the creditors.

Antique furniture constitutes collectors' items, not household goods or other means of subsistence. Antique furniture therefore forms part of the insolvent estate.

- (3) This statement is false. The assets of the duly constituted Smith Family Trust, although vesting in the trustee of that trust (Boris Green), do not form part of his personal estate on insolvency (s 12 of the Trust Property Control Act 57 of 1988). In this regard, it is important that you should distinguish between two different trustees: Boris Green (who is the trustee of the Smith Family Trust), and the trustee of the insolvent estate of Boris Green. You should also bear in mind that there is no indication in the facts of the question that the estate of the Smith Family Trust itself has been sequestrated.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 8

VESTING OF THE ASSETS OF THE SOLVENT SPOUSE

In this study unit, we introduce you to the consequences that the sequestration of the estate of a spouse in a marriage **out of community of property** (eg, Tenza) has on the other spouse (Mpho), whose estate has **not been sequestrated** (the solvent spouse).

It is **essential** that you remember that **in this study unit we shall deal only with a marriage out of community of property**, in which each spouse has a separate estate. If you are still not sure about the difference between marriage out of community of property and marriage in community of property, refer to the relevant explanation and diagrams at the beginning of study unit 7 now. **Do not make the mistake of thinking that section 21 of the Insolvency Act (which you will examine in the present study unit 8) applies to a marriage in community of property.** Remember that in a marriage in community of property there is a single joint estate; consequently, if one spouse is declared insolvent, the other spouse is also insolvent. There can then be no solvent spouse in a marriage in community of property if one of the spouses has been declared insolvent.

After completing this study unit you should be able to

- understand the reasons for the vesting of the assets of the solvent spouse in the trustee of the insolvent spouse
- know the grounds for the release of the solvent spouse's property
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

Study Hockly 6.1 up to and including 6.2.1.

Omit Hockly 6.2.2 up to and including 6.5.

6.1 Vesting of assets in trustee

In terms of section 21(1) of the Insolvency Act, an additional effect of a sequestration order is to vest the separate property of the spouse of the insolvent in the trustee, as though that separate property were property of the insolvent estate.

Activity 1

Explain why the assets of the solvent spouse vest in the trustee of the insolvent estate in terms of section 21(1), and argue whether you think that this rule is just.

Feedback

Imagine how the creditors may be deceived and prejudiced by an insolvent spouse's transferring his assets to his wife prior to sequestration. It is very difficult to prove that these transactions are simulated. Sometimes the assets in the two spouses' estates are entwined.

6.1.1 Meaning of "solvent spouse"

Note also that where the "spouses" are married section 21 can apply only to marriages **out of** community of property.

You must know the wide definition of the word "spouse" in section 21(13) of the Insolvency Act 1936, as well as the effect of the Civil Union Act 17 of 2006 on the Insolvency Act.

In the first place, section 21(13) of the Insolvency Act defines "spouse" as not only a wife or husband in the legal sense, but also a wife or husband by virtue of a marriage according to any law or custom, and also a woman living with a man as his wife or a man living with a woman as her husband, although they are not married to one another.

Secondly, since the commencement of the Civil Union Act 2006 on 30 November 2006, the definition of the term "spouse" in the Insolvency Act has by implication been amended to include persons of the same sex or of the opposite sex who have entered into a civil union. The Civil Union Act was introduced in order to accord same-sex couples the same family law rights and obligations, and the same status, benefits and responsibilities accorded to opposite-sex couples (see the preamble to the Civil Union Act). Section 1 of the Civil Union Act defines "civil union" as the voluntary union of two persons who are both 18 or older, which is solemnised and registered by way of either a marriage or a civil partnership, according to the procedures described in the Civil Union Act, to the exclusion, while it lasts, of all others. Furthermore, a "civil union partner" means a spouse in a marriage or a partner in a civil partnership, as the case may be, concluded in terms of the Civil Union Act (s 1), and the Civil Union Act applies to civil union partners joined in a civil union (s 3). A consequence of a civil union is that the legal consequences of a marriage in terms of the Marriage Act 25 of 1961 apply, with relevant contextual changes, to a civil union (s 13(1) of the Civil Union Act). Furthermore, a reference to marriage in any other law, including the common law, includes (with relevant contextual changes) a civil union. In addition, a husband, wife or spouse in any other law (including the common law) includes a civil union partner (s 13(2)(a)-(b) of the Civil Union Act).

Accordingly, for the purposes of section 21(13) of the Insolvency Act, this alteration to the law would mean that a civil union partner falls within the definition of the word "spouse", and that section 21 of the Insolvency Act will now apply with equal force to such partners in a civil union.

6.1.3 Postponement of vesting

In terms of section 21(10) of the Insolvency Act, the vesting of the solvent spouse's property in the trustee of the insolvent spouse's estate may be postponed.

Activity 2

Discuss the circumstances in which the court will grant a postponement of vesting to the solvent spouse.

Feedback

Make sure that you discuss all the elements which the solvent spouse must prove, and the contingencies against which she must protect the interests of the insolvent estate.

6.2.1 Categories of property which must be released

Make a clear distinction between the release of property in terms of section 21(2) of the Insolvency Act and the setting aside of an impeachable disposition. Property acquired in terms of a marriage settlement must be released in terms of section 21(2)(b). Dispositions in terms of an antenuptial contract will usually be dispositions without value under section 26 of the Insolvency Act (discussed in Hockly 12.2.1). Although the trustee must initially release the property to the solvent spouse under section 21(2) of the Insolvency Act the trustee will still be able to set aside such a disposition as a disposition without value if the requirements of section 26 are proved and the solvent spouse cannot prove the requirements of section 27 of the Insolvency Act (see Hockly 12.2.1).

Section 21 of the Insolvency Act used to be especially important in the case of donations made by the insolvent spouse to the solvent spouse. At common law, donations between spouses (except donations in terms of an antenuptial contract) were void. The solvent spouse could therefore not obtain the release of such a donation, because the donated asset had not been acquired by a valid title as against the creditors of the insolvent spouse. Now, however, donations between spouses are valid. The release of the donated item may therefore be obtained, subject to the possibility of the trustee's challenging the donation and having it set aside as a disposition without value in terms of section 26 of the Insolvency Act.

Activity 3

- (1) Name the five instances in which the solvent spouse may apply to have property released in terms of section 21(2).
- (2) Discuss the common-law prohibition of donations between spouses and its abolition in terms of section 22 of the Matrimonial Property Act.

Feedback

- (1) The grounds are set out in Hockly 6.2.1.

- (2) When discussing the prohibition of donations make sure that you discuss the requirements where a donation has not yet been carried out.

SELF-TEST QUESTIONS

- (1) A and B are married in year 1. The accrual system applies to their marriage in terms of a duly registered antenuptial contract. For the purposes of the accrual system, B declares the commencing nett value of his estate as R5 000 and an old antique sports car. B later sells the sports car for R100 000. This amount is deposited into a savings account. During year 3, A's estate is sequestrated. The trustee of A's insolvent estate takes possession of all the assets, including the savings account. Explain to B what the position is in respect of these items of property.

(5)

- (2) Mr and Mrs Tenza and Mpho Zondi are married out of community of property and profit and loss. On the birth of their first child, Tenza donates his old Mercedes Benz motor vehicle to Mpho, and then buys himself a very flashy new BMW motor vehicle. The following year, Tenza's estate is sequestrated. Explain the position regarding the Mercedes Benz motor vehicle that Tenza donated to Mpho.

(5)

- (3) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

A solvent wife will not be able to obtain the release of property which was donated to her by her husband while she knew that he was going to apply for the voluntary surrender of his estate.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) All B's property passed to the trustee of A's insolvent estate. But B may apply for the release of property which he owned prior to his marriage to A. The Matrimonial Property Act states that if the accrual system applies to a marriage, a person may in writing declare the value of his estate, in order to prove the nett value of his estate at the commencement of his marriage. B may also apply for the release of property which was obtained with the property which belonged to him prior to his marriage to the insolvent, or the income or proceeds of that property. Although B declared in writing that his estate prior to the commencement of the marriage consisted of an old antique motor vehicle and R5 000, section 21(2)(e) of the Matrimonial Property Act provides that such a declaration in itself does not serve as proof in an application for release in terms of sections 21(2) or 21(4) of the Insolvency Act. B will therefore have to furnish other proof of the fact that the money and the car already belonged to him before the conclusion of the marriage.
- (2) Under section 21(1) of the Insolvency Act, the property of the solvent spouse (Mpho) vests in the trustee of the insolvent estate. In terms of section 21(2)(c), however, the trustee must release property if it is proved that it was acquired during the marriage by a title valid as against creditors of the insolvent's estate. At common law,

donations between spouses were prohibited, except those in terms of an antenuptial contract. Section 22 of the Matrimonial Property Act abolished this common-law prohibition. Accordingly, Mpho is entitled to the release of the Mercedes Benz motor vehicle. (Nevertheless, the possibility exists that the donation of this vehicle could be set aside as a disposition without value in terms of s 26.)

- (3) This statement is true. The solvent wife will not be able to prove that she acquired the property by valid title during the marriage (s 21(2)(c)). She will not be able to prove that she acquired the property in good faith, because an important factor in determining the question of good faith is whether the parties, at the relevant time, were aware of the alienator's actual or imminent insolvency. If the husband, to the knowledge of his wife, was intending to apply for the voluntary surrender of his estate, it is probable that he was actually insolvent at the time that he donated the property to his wife. See Hockly 6.2.1(iii).

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 9

UNCOMPLETED CONTRACTS AND LEGAL PROCEEDINGS NOT YET FINALISED

In this study unit, we deal with uncompleted contracts entered into by the insolvent (such as Tenza). The general rule is that sequestration does not suspend or put an end to a contract entered into by the insolvent and another person.

After completing this study unit you should be able to

- explain the law regarding a contract carried out by the insolvent, but not the other party, at the time of sequestration
- discuss the trustee's election as regards a contract which has not been carried out by the insolvent, and the statutory limitations on the exercise of this election
- describe the consequences of the trustee's decision to repudiate or to abide by a contract
- draft a notice in terms of section 36(1) of the Insolvency Act
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly chapter 7 up to and including 7.2.5.

7.2.2 The trustee's election

Note that Hockly 7.2.2 discusses **the election (the choice) that the trustee makes about whether to uphold or to repudiate an unperformed contract**. Hockly 7.2.2 does not deal with the creditors' election of the person who will be the trustee of the insolvent estate; that subject will be discussed in Hockly chapter 10 and study unit 13.

Note that the trustee elects (chooses) to uphold (or comply with) the contract, or else to repudiate (reject the obligations under) the contract. Do not make the mistake of stating that when the trustee repudiates the contract, he or she voids the contract or that the contract is void or voidable. Repudiation of a contract is not the same as voiding the contract.

Repudiation is a breach of contract in that the repudiating party indicates by words or conduct that he or she does not intend to perform his or her obligations under the contract. Repudiation gives the other party to the contract (the aggrieved party, the victim of the

breach of contract) the right to claim the appropriate remedies for breach of contract (see Hockly 7.2.4).

One of the remedies for breach of contract is discussed in Hockly 7.2.2 – **specific performance**. The plaintiff seeking this remedy requests the court to order the contracting party who is in breach of contract to carry out his or her obligations under the contract; in other words, to do what he or she promised. (For example, the purchaser of a plot of land may request the court to order the seller of the land to carry out the obligation under the contract of sale to transfer the land to the purchaser.) Usually, the court would exercise its discretion to grant or to refuse the order of specific performance. But where sequestration has occurred before the insolvent has performed his or her contractual obligations the court would refuse to grant specific performance in favour of the creditor who requests the order of specific performance. If the court were to grant specific performance in favour of this particular creditor this creditor would thus be granted an unfair advantage over the other creditors in the *concursum creditorum*. This particular creditor awarded the order of specific performance would be entitled to receive full performance from the trustee under the terms of the original contract, whereas the other creditors in the *concursum creditorum* would have to be content with less than full performance.

It is important to note the difference between a contract that has been **concluded** and a contract that has not been **completed**. When the parties negotiating the terms of a contract reach an agreement and form the contract, the contract is **concluded**; the parties have entered into the contract. That contract then imposes rights and duties on the parties to the contract, and these duties to perform may perhaps still not have been performed by the time that the estate of one of the parties to the contract is sequestrated. At that stage, the contract has been concluded (because the contract has been formed and is binding on the parties to the contract), but it has not yet been **completed** (because one or more of the obligations of performance set by the contract have not yet been carried out). So do not make the mistake of thinking that such an uncompleted contract is not yet concluded.

In studying Hockly chapter 7, remember that the principles set out in Hockly 7.2, 7.2.1, 7.2.2, 7.2.4, and 7.2.5 constitute the basic general principles of the effect of sequestration on contracts that have not been completed by the insolvent. These principles are derived from the South African common law of contract and insolvency. These principles are then varied, or changed, or limited, by various provisions of statute law, such as those of the Insolvency Act.

7.2.3 Statutory controls on exercise of trustee's election

7.2.3(i) **Contract to acquire immovable property**

Section 35 of the Insolvency Act applies to any contract for the **acquisition of immovable property**, if the insolvent has not yet received transfer at the time of the sequestration of his estate. At this point, we need to give you a short explanation of the difference between the law of contract and the law of property. The law of contract forms part of the law of obligations. The **law of obligations** deals with the creation of **personal rights** between the holder of the right and the person who is bound by the relevant obligation. These rights apply as between the parties to the particular obligation. In the case that we are discussing, the personal rights would arise, for example, by virtue of a contract of sale between the seller of the immovable property and the purchaser of the immovable property.

Now we shall discuss the **law of property**. The law of property deals with the creation of what are called **real rights**: rights that apply in respect of an object or objects against all persons everywhere, and not merely (as personal rights do) as between the parties to the particular obligation. The most important real right is ownership. Lesser real rights may include rights in respect of property belonging to another. Examples of such lesser rights in another person's property include rights of real security such as mortgage and pledge (see Hockly 16.2.1 and Hockly 16.2.3 respectively). It is also important to note that the ownership of property passes from one person to another person either by way of the **registration of the transfer of IMMOVABLE property** in the Deeds Office, or by way of the **delivery of MOVABLE property**. An example of immovable property is a plot of land and the buildings standing on that plot of land. Examples of immovable property are your pen or your motor vehicle.

At this stage, you may be wondering how this discussion of the law of property is relevant to the contract to acquire immovable property. **The crucial point to notice is that in the situation to which section 35 of the Insolvency Act applies the immovable property concerned has not been transferred from the seller of the immovable property to the purchaser of the immovable property.** Transfer of such property takes place by means of the registration of the relevant title deed in the appropriate Deeds Office. (There are Deeds Offices in Pretoria, Cape Town, Johannesburg, Pietermaritzburg, Bloemfontein, King William's Town, Kimberley, and Mthata. The purpose of registration in the Deeds Office is partly to provide notification to every other person about the passing of ownership from one person to another person.) So, in the present situation to which section 35 of the Insolvency Act applies, **the seller is still the registered owner of the immovable property.** Accordingly, this property is part of the estate of the seller, not the purchaser. If the purchaser's estate is sequestrated the immovable property does not automatically fall into the insolvent estate. Section 35 provides for the procedure that the seller must follow in order to prevent the immovable property from falling into the purchaser's insolvent estate. So do not make the mistake of thinking that, in the present situation, the immovable property falls into the insolvent estate of the purchaser, or that this property vests in the trustee of that insolvent estate, or that the seller must recover or get back the property from the insolvent estate or the trustee.

In the first paragraph of Hockly 7.2.3(i) you will find a discussion of two further remedies for breach of contract. The first remedy is **cancellation**, and the second remedy is a **claim for loss suffered as a result of the nonfulfilment of the contract**.

Cancellation of the contract puts an end to the contract. In the present circumstances in relation to the contract to acquire immovable property (Hockly 7.2.3(i)), the trustee's repudiation of the obligations under the contract entitles the seller to seek an order of cancellation from the court (s 35). When the contract is cancelled the parties are usually also obliged to return what they can of each other's performances to each other. This duty is known as restitution. The duty of restitution may, however, be excluded by a forfeiture clause (see Hockly 7.2.4, second bullet). A forfeiture clause prevents the party who is in breach of contract from claiming the restitution of his or her own performance.

The second remedy mentioned in the first paragraph of Hockly 7.2.3(i) is the remedy of **compensation for loss arising from the nonfulfilment of the contract**. This remedy under section 35 of the Insolvency Act is for **damages** caused by the trustee's breach of contract

(the trustee's repudiation). The purpose of such an award of damages is to put the aggrieved party, so far as this aim can be achieved by an award of money, in the position that he or she would have been if the contract had been performed. Damages may be claimed in addition to the remedy of cancellation, and will be a nonpreferent, and therefore a concurrent (ordinary), claim against the insolvent estate. (The difference between preferent claims and concurrent claims will be discussed in ch 16 of Hockly.)

Note also that section 35 of the Insolvency Act is not limited to contracts of purchase of immovable property, although in practice what is usually involved is a contract in terms of which the (later) insolvent has bought immovable property; that person also has to pay the purchase price in instalments; and he is entitled to transfer only after payment of the full purchase price. Note further that section 35 does not apply at all to the case where the **seller** of immovable property goes insolvent before transfer has been given to the buyer. The latter situation is governed by the common law and chapter II of the Alienation of Land Act 68 of 1981 (full details of which are to be found in Hockly 7.2.7(ii)).

Having studied section 35 of the Insolvency Act, which deals with the position where the immovable property has not been transferred to the estate of the insolvent acquiring it, you may perhaps wonder about what happens in the **different situation** in which the **immovable property HAS been transferred to the estate of the insolvent**. In other words, the immovable property has been registered in the name of the acquirer in the Deeds Office, and the acquirer is then declared insolvent before making his or her performance under the contract. Note that this is not the situation dealt with under section 35 of the Insolvency Act. Instead, the relevant property forms part of the insolvent estate (s 20(2) of the Insolvency Act, discussed in Hockly 5.2). Now the previous owner of the immovable property is in a weak position at **common law**. He or she no longer owns the immovable property. He or she merely has a personal right under the law of contract to claim the insolvent debtor's performance. But because the remedy of specific performance will not be granted in favour of this creditor against the trustee of the insolvent estate (see Hockly 7.2.2), this creditor's claim against the insolvent estate will be an ordinary, concurrent claim for damages for breach of contract. This concurrent creditor will therefore rank for a dividend.

7.2.3(ii) Hire of property

A contract of lease is a contract under which the one party (the lessor, who in the case of immovable property may also be called the landlord) makes the use and enjoyment of property available to another party (the lessee, who in the case of immovable property may also be called the tenant) in return for the payment of the rent, which usually is paid in money. In the situation discussed in Hockly 7.2.3(ii), it is the **lessee** who is **hiring** the property (movable or immovable) **from the lessor**, and so the contract is known as the **hire of property**.

The landlord's tacit hypothec, mentioned in the second bulleted item of the list, will be discussed in more detail in relation to Hockly 16.2.2.

In relation to Hockly 7.2.3(ii), section 37 of the Insolvency Act applies only if the estate of the **lessee** of property (whether movable or immovable) is sequestrated.

If it is the estate of the **LESSOR OF IMMOVABLE PROPERTY** (ie, the landlord of immovable property) that is sequestrated before the lease period expires, the position is determined by the common law, and full details are to be found in Hockly 7.2.7(i).

7.2.4 Consequences of repudiating contract

Hockly makes it clear that if the solvent party cancels the contract by accepting the trustee's repudiation, the solvent party may reclaim an asset already delivered to the insolvent **only if he (the solvent party) still owns it**. If ownership has already passed to the insolvent the asset falls into the insolvent estate. (See the explanation of the passing of ownership of property above, in our discussion of Hockly 7.2.3(i).) It follows that the solvent party cannot compel the trustee to return the asset itself. The solvent party will have to be satisfied with a concurrent claim for damages. Note that the concurrent claim for loss that is mentioned in the final bulleted item of the list is a claim for damages.

7.2.5 Consequences of abiding by contract

The trustee may elect to carry on and complete the contract and, in that way, take up the position of the insolvent. See Hockly 7.2.2 for the election (the choice) that the trustee may make to continue with the contract. The case of *Bryant & Flanagan (Pty) Ltd v Muller and another NNO 1978 (2) SA 807 (A)* is a good illustration of the basic principle that if the trustee upholds the contract he upholds the contract **as a whole**. The trustee (and the other party to the contract) must then carry out the whole contract **in full**. Usually the trustee may therefore not uphold the contract in part and repudiate it in part. But the exception to this general rule is that if the contract is in fact **divisible**, the trustee may uphold the contract in part and repudiate it in part. Whether a contract is divisible depends on the nature of the performances in terms of it and on the intention of the parties. Tenza's contract of sale to purchase his new house, and his contract of sale with City Motors to purchase his new Mercedes Benz, are both contracts that are by nature indivisible. But suppose that Charlie buys two horses from David. The parties agree that Charlie will pay R500 for the one horse, and R600 for the other one. Here the contract is divisible by its nature. Unless it appears that the parties intend an indivisible contract (eg, Charlie says that he needs the two horses as a team to pull his horse-drawn cart), the contract will be divisible. If David's estate is sequestrated the trustee will be entitled to adopt the position that he will deliver the second horse against payment of R600, but that he refuses to deliver the other horse. The consequence of this decision will be that Charlie will receive the one horse against payment of R600, but that he will have a mere concurrent claim for damages with respect to the other horse.

In the final paragraph of Hockly 7.2.5 there is only a broad outline of section 36 of the Insolvency Act, and so it is necessary to say something more about it. Section 36 regulates the position in the case of a **CASH SALE** of **MOVABLE** property where the **BUYER'S** estate is sequestrated **before he has paid the full purchase price**, but **after the property has been delivered to the buyer**. A contract of sale is a cash sale if the purchase price is to be paid on delivery of the property. That is the case when the parties have expressly agreed that the purchase price is to be paid on delivery of the property, or when they have not agreed at all about when the purchase price must be paid.

The opposite of a **cash sale** is a **credit sale**. In the case of a credit sale, the parties expressly agree that the seller will deliver the property, but that the purchase price will be payable only on an agreed later date.

The difference between a cash sale and a credit sale is also important as regards the passing of ownership in the thing sold. In the case of a cash sale of movable property, ownership passes to the buyer only when the property has been delivered to him **and he has paid the full purchase price**.

In the case of a **credit** sale of movable property, however, ownership passes already when the property is **delivered** to the buyer, unless the parties expressly agree that ownership will pass only at a later stage.

In a **cash sale**, usually the seller delivers the movable property to the buyer, and, at the same time, the buyer pays the purchase price of the property to the seller. So you may probably find it strange that there is also a cash sale if the seller delivers the property to the buyer, but the buyer nevertheless does not pay the purchase price to the seller immediately. But that situation is indeed possible. If the buyer has to pay the purchase price against delivery, but the seller still allows the buyer to take possession of the property without simultaneously paying the purchase price, **the contract remains a cash sale**. Accordingly, ownership of the movable property sold passes only when the purchase price is paid. This result happens especially where the buyer pays by means of a cheque. If the cheque is not paid out by the bank (and so, in colloquial language, “the cheque bounces”), then ownership of the movable property sold has not passed to the buyer, even though the movable has been delivered. Because the seller then remains the owner of the movable property sold, the seller should be able to recover the possession of that property from the buyer.

At this point, we wish to correct a mistake that students often make when answering questions about cash sales and section 36 of the Insolvency Act. Do not make the mistake of thinking that, in a cash sale of a movable, the ownership of the movable property sold passes automatically from the seller to the buyer when the movable property is delivered to the buyer. As you have seen from the discussion of cash sales in the previous paragraph, the ownership of the movable property will pass only when the purchase price is paid.

Because the seller of the movable under a cash sale remains the owner of the movable until the purchase price is paid this principle is recognised by section 36 of the Insolvency Act. Nevertheless, section 36 does place some limitations on that principle.

Consider the following example of the application of section 36: Tenza sells his car to Bobby. The parties do not specifically agree on when the purchase price is to be paid. Tenza delivers the car to Bobby, and Bobby hands Tenza a cheque for the purchase price. Bobby’s estate is sequestrated two days later. The bank refuses to pay the cheque, because there is not enough money in Bobby’s bank account. Tenza may reclaim his car from the buyer. To do so, Tenza must follow the procedure under section 36. So Tenza must give written notice, within 10 days after **delivery** of the car, to Bobby, the Master, or Bobby’s trustee that he (Tenza) reclaims the car. If the trustee then disputes Tenza’s right to reclaim the car, he (Tenza) must, in addition, institute legal proceedings to enforce his right within 14 days after he has received notice of the trustee’s attitude. If Tenza fails to take these steps the car will be an asset in the insolvent estate, and Tenza will have only a concurrent claim for the purchase price.

There are some other features of section 36 of the Insolvency Act that you should note. First, we wish to concentrate on the difference between a cash sale and an instalment agreement. Section 36 concerns a cash sale. Section 36 does not therefore concern an instalment agreement, which is defined by section 1(a), (b), and (c) of the National Credit Act 34 of 2005 (and which you will study in Hockly 7.2.8 on the instalment agreement). So do not make the mistake of confusing the relevant legal principles that apply to these two different kinds of contracts. In other words, do not write that the seller under a cash sale acquires a tacit hypothec when the buyer's estate is sequestrated and that because one cannot have a hypothec over one's own property the right of ownership passes automatically to the buyer's estate and the seller thus acquires security for his claim for the price against the insolvent estate. Those consequences come about when the estate of the purchaser under an **instalment agreement** is sequestrated (see Hockly 7.2.8). In a **cash sale**, by contrast, **the seller remains the owner of the property if he or she follows the procedure under section 36**. So you should not write that the seller has a secured claim under section 36 of the Insolvency Act.

Another point to notice in section 36 is that although the seller is required to notify the buyer, the Master, or the trustee in writing, there is no obligation in section 36 that the trustee's disputing of the seller's right to the property has to be in writing as well.

In addition, there is no requirement in section 36 that the trustee has to make his election to uphold or to repudiate the cash sale of the movable property within six weeks after receiving written notice from the seller. That requirement of six weeks is a requirement under section 35, which deals with a contract to acquire immovable property. Section 36, by contrast, applies to a cash sale of **movable** property. So guard against confusing the provisions of sections 35 and 36 in this regard.

A further mistake regarding the time periods in section 36 that students often make concerns the period of 14 days. Note that the period of 14 days relates to the time **after the trustee has disputed the seller's right to reclaim the property**. Do not therefore make the mistake of thinking that the period of 14 days is the period of 14 days after the seller submits the written notice to the buyer, the Master, or the trustee. In other words, do not make the mistake of thinking that, once the seller has given the written notice, the trustee then has 14 days in which to dispute the seller's right to reclaim the property.

Activity 1

In this activity, we give you practice in writing a notice in terms of section 36(1).

Suppose that in the above example of the sale of the car you are the seller, Tenza, and the buyer is Bobby. The sale and delivery took place on 14 August in Bloemfontein in the Free State. The purchase price was R1 000, and Bobby handed you a cheque as payment. The cheque remains unpaid, because of lack of funds in Bobby's account. You have photocopied the details of the car sold from your records. Bobby's estate was sequestrated on 16 August.

- (1) How many days do you have in which to reclaim the car?

- (2) Write the body of the notice in which you reclaim your car. You prefer to give notice to the Master of the High Court, though you could also have given notice to the purchaser (Bobby) or the trustee of Bobby's insolvent estate, once appointed.

Feedback

- (1) You have 10 days from the date of **delivery** (14 Aug), not 10 days from the date of the sequestration of Bobby's estate (16 Aug).
- (2) The notice will read more or less as follows:

NOTICE IN TERMS OF SECTION 36(1) OF ACT 24 OF 1936

Be pleased to take notice that on 14 August 20.. Bobby bought a car, a red Mercedes Benz, from me. Details of the car are set out in the annexure to this notice.

The contract provided for delivery of the car to Bobby in return for payment of the purchase price of R1 000 by means of a cheque.

In terms of the contract of sale, I delivered the car to Bobby on 14 August 20.., and he handed me a cheque drawn on Alpha Beta Bank Ltd for the purchase price of R1 000. On 16 August 20.., Bobby's estate was sequestrated. Alpha Beta Bank Ltd refuses to pay the cheque, because of lack of funds in the drawer's account. Bobby has not paid the price or any part of it.

I therefore give notice in terms of section 36(1) of the Insolvency Act 24 of 1936 that I reclaim the car.

(signature)

Tenza

SELF-TEST QUESTIONS

- (1) In terms of a written contract of sale, Tenza sold Bobby 500 valuable books from his (Tenza's) library. A month later, after Bobby had already paid the full purchase price, but before Tenza had delivered the books, Tenza's estate was sequestrated. Advise Bobby on the effect of the sequestration of Tenza's estate on this contract. (9)
- (2) Chad sold his house to Dave for R3 million. Before the registration of the transfer in the Deeds Office, Dave's estate was sequestrated. Advise Chad on the steps he should take in giving notice to the trustee of Dave's insolvent estate. (5)
- (3) Explain what the trustee should do in the case of (2) above if he is a provisional trustee. (2)

- (4) Bobby let his house to Tenza under a written agreement of lease in terms of which an annual rent is payable. Tenza's estate was later sequestrated. Advise the trustee on the effect of the sequestration on this contract. (9)
- (5) Discuss whether section 37 of the Insolvency Act applies to the lease of a threshing machine, furniture or horses. (2)
- (6) Bobby contracts to build a wall for Tenza in return for payment of R500 on completion of the work. Tenza's estate is sequestrated when Bobby has finished building half the wall. Tenza's trustee elects to continue with the contract. Bobby finishes the wall and claims R500. Tenza's trustee says that he is obliged to pay Bobby only R250 for the work done after sequestration, and that Bobby has a concurrent claim of R250 for the work done before sequestration. Advise the parties whether the trustee is justified in his proposed payment. (8)
- (7) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

Britney's estate is sequestrated before she has been registered as the new owner of the farm that she bought from Allan, and so if the trustee of Britney's estate duly elects to uphold (continue with) this contract to buy Allan's farm, the court will probably grant Allan an order requiring Britney's trustee to pay Allan the purchase price if there are no good reasons why Britney's trustee should refuse to pay the purchase price to Allan.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) As regards this contract which has not been completed by the insolvent, Tenza, at the time of the sequestration of his estate, the general rule is that the contract is not terminated by sequestration. The trustee may elect whether to perform in terms of the contract or not. The other party to the contract may not, however, claim specific performance of the obligation to deliver the books. The trustee's power to repudiate the contract must be exercised in the interests of the *concursum creditorum*. He must therefore seek and adopt the instructions of the general body of creditors, and must not choose a course of action that harms the interests of the *concursum*. Here the *concursum* would instruct the trustee to repudiate the contract with Bobby, so that the valuable books may be sold and the proceeds may thereby increase the free residue. Bobby will then be left with a concurrent claim for repayment of the purchase price, and for damages.

Once he has decided to uphold or to repudiate the contract the trustee may not change his mind. If he does not make his decision within a reasonable time he is assumed to repudiate the contract.

- (2) The election available to the trustee of Dave's insolvent estate is regulated by section 35 of the Insolvency Act. Chad should send the trustee a written notice requiring the trustee to elect whether to uphold or to repudiate the contract of sale. After receiving the notice, the trustee has six weeks in which to make his election. If he does not make his election and notify Chad accordingly, Chad may apply to court for the cancellation of the contract and the return of the possession of the farm. Chad may also prove a concurrent claim against the insolvent estate for loss suffered as a result of the nonfulfilment of the contract.
- (3) The provisional trustee must seek directions from the Master. If the Master does not respond, that trustee may use his own discretion.
- (4) The contract is not terminated by the sequestration of the lessee's estate. The trustee may elect to continue or to terminate the lease, provided that he acts in the interests of the general body of creditors. If the trustee decides to terminate the contract he must do so by giving written notice to the lessor, Bobby (s 37(1) of the Insolvency Act). If the trustee does not, within three months of his appointment, notify Bobby that he wishes to continue the lease on behalf of Tenza's estate the trustee is deemed to have terminated the lease (s 37(2)). Therefore, if the trustee decides to uphold the contract, within three months of his appointment he must give written notice to Bobby that he wishes to continue the lease on behalf of Tenza's estate.

If the trustee terminates the lease the insolvent estate loses any right to compensation for improvements that Tenza may have made to the lease object, unless those improvements were made in terms of an agreement between Tenza and Bobby (s 37(4)). Bobby, as the lessor, has a preferent claim for the rent payable from the date of sequestration to the date of the termination of the lease; this claim is included in the costs of sequestration (s 37(3)). Bobby also has a concurrent claim for damages sustained as a result of the premature termination of the lease (s 37(1)).

- (5) Section 37 applies to contracts of lease of immovable property **and** of movable property (see *Montelindo Compania Naviera SA v Bank of Lisbon and SA Ltd* 1969 (2) SA 127 (W)). It therefore does apply to the lease of a threshing machine, furniture, or horses.
- (6) Because the trustee has elected to carry on and complete the contract, he may insist on receiving any performance owed by Bobby under the contract. Bobby has duly completed his performance. The trustee is also bound to perform all the insolvent's duties, including unfulfilled past ones, and is not entitled to different treatment simply because of the sequestration. In *Bryant & Flanagan (Pty) Ltd v Muller and another NNO* 1978 (2) SA 807 (A), the liquidators tried to argue that the builder had only a concurrent claim against the insolvent estate for work done before the liquidation of the company. This argument did not impress the Appellate Division (as the Supreme Court of Appeal used to be called). That court held that because the liquidators had upheld the contract the builder was entitled to full payment for the work done before the company's liquidation. Therefore Bobby would similarly be entitled to full payment for the work done before the sequestration, and for the work done after the sequestration. The payment to Bobby for the work is an expense which forms part of the costs of sequestration. It must be paid in full from the free residue of the estate (see Hockly 16.3.2(iii) on the costs of sequestration). If the free residue is insufficient

to cover the amount, the unpaid amount of the costs of sequestration must be paid from contributions levied against creditors who have proved claims against Tenza's estate.

- (7) This statement is true. Because the farm is immovable property and has not been transferred to Britney before her estate is sequestrated, section 35 of the Insolvency Act applies to this contract for the sale of an immovable property. Under section 35, however, Britney's trustee has duly (in a timely manner) elected to **uphold (abide by)** the contract, and not to repudiate the contract. See Hockly 7.2.3(i). At this point, the problem is answered in terms of the **common law** concerning the effect of the trustee's decision to abide by the contract. See Hockly 7.2.5. Because Britney's trustee has elected to carry on and complete this contract he has "stepped into the shoes" of the insolvent, Britney. The trustee is therefore bound to carry out all the duties of the insolvent, including duties that fell due before sequestration. One of the duties of the insolvent (Britney) under this contract is to pay the purchase price of the immovable property to Allan. Because there are no good reasons why Britney's trustee should refuse to pay the purchase price, the court will probably grant Allan an order requiring Britney's trustee to pay Allan the purchase price.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 10

UNCOMPLETED CONTRACTS AND LEGAL PROCEEDINGS NOT YET FINALISED

In this study unit, we shall discuss contracts which are suspended or which terminate automatically on sequestration. We shall also examine contracts which a trustee cannot repudiate.

After completing this study unit you should be able to

- identify which contracts form exceptions to the general rule that sequestration does not terminate the insolvent's uncompleted contracts
- distinguish between the preferent part and the concurrent part of a former employee's claim against the insolvent estate of the former employer
- discuss the effect of sequestration on a contract of mandate
- explain the exclusion or limitation of the trustee's power to repudiate some contracts
- describe how the doctrine "huur gaat voor koop" protects the lessee of immovable property upon the sequestration of the lessor's estate
- explain the protection offered by chapter II of the Alienation of Land Act 68 of 1981, as contrasted with the lack of protection at common law
- discuss the opposing views on the effect of sequestration of the seller's estate upon an instalment agreement
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly 7.2.6 up to and including 7.2.7.

7.2.6 Contracts which are suspended or which terminate on sequestration

There are certain exceptions to the rule that insolvency does not suspend or put an end to the insolvent's uncompleted contracts.

7.2.6(i) Employment contract made by insolvent (as employer)

Under the contract of employment, the employee provides his or her personal services to the employer, in return for remuneration paid by the employer to the employee. Hockly 7.2.6(i) applies to the situation in which it is the **employer** whose estate is sequestrated. This situation is dealt with in terms of section 38 of the Insolvency Act. The contract of employment is **suspended** when the employer's estate is sequestrated. Subsequently, the contract of employment may be terminated in one of two ways, namely:

- (1) by the decision of the trustee (s 38(4)), or
- (2) by the effluxion of the period of 45 days after the appointment of the trustee (s 38(9)(a))

The word "effluxion" means "expiry".

If the employee's contract is terminated the ex-employee has a preferent claim against the insolvent estate (see Hockly 16.3.2(v)). In so far as this former employee is entitled to an amount of arrear remuneration which exceeds the limits of the preference, this former employee must prove an ordinary concurrent claim for that remuneration. The former employee may also prove a concurrent claim for loss which he or she has sustained because of the premature termination of his or her employment contract (see s 38(10)-(11)).

7.2.6(ii) Mandate

It is important to understand that the authoritative rule of South African common law, as laid down in *Goodricke & Son v Auto Protection Insurance Co Ltd (in Liquidation)* 1968 (1) SA 717 (A) and Voet 17.2.17, is that the contract of mandate **terminates** when the estate of either the mandator (the principal) or the mandatary (the agent) is sequestrated. When the contract of mandate terminates, it comes to an end, and it is not suspended.

7.2.7 Contracts which trustee cannot repudiate

7.2.7(i) Lease of immovable property

Hockly 7.2.7(i) states that the rule "huur gaat voor koop" is the reason that the trustee when selling **immovable** property which forms part of the insolvent estate must in principle sell it subject to a contract of lease. According to that rule, a lessee of immovable property (ie, a tenant) establishes a real right to the subject of the lease. Consequently, the trustee of the insolvent lessor **of immovable property** may claim the leased thing from the lessee and sell it free of the lease (because, according to general principles, the trustee is not compelled to perform the contract of lease (see Hockly 7.2.2)). If the trustee therefore does not wish to continue the contract of lease the lessee will have to return the immovable property and prove a concurrent claim for damages against the insolvent estate.

Note that the rule "huur gaat voor koop" does not apply to movable property.

7.2.7(ii) Sale of land on instalments

Hockly 7.2.7(ii) deals with the alienation of land, and chapter II of the Alienation of Land Act provides important protection to the purchaser in the case where the seller becomes insolvent. The provisions of that Act become quite complicated when the land has been sold more than once and transfer has not yet been given to the intermediary. Here we limit ourselves to the simpler case where intermediaries are not involved. The protection of the purchaser takes two forms. He may obtain transfer, even though the property is an asset in the estate of the insolvent seller. But if he cannot make use of his right to take immediate transfer, or if he prefers not to do so, and the trustee is also not prepared to proceed with the contract on its original terms, section 20(5) of the Alienation of Land Act offers the purchaser a secured claim for the repayment (with interest) of the amount which he has already paid towards the purchase price, provided that the contract has been recorded against the title deeds of the property.

Consider the following example of the application of chapter II of the Alienation of Land Act: Before the sequestration of his estate, Tenza sold his house to Bobby in terms of a contract which falls under chapter II. The contract has been registered against the title deeds of the property, but a prior mortgage has also been registered against the property. At the time of the sequestration of Tenza's estate, Bobby has already made payments totalling R80 000, and Bobby still owes R100 000 in terms of the contract of sale. The R100 000 is more than the total of the amount outstanding on the mortgage, levies and contributions in relation to the property and the sequestration and administration costs concerning the property. Bobby may now claim transfer from the trustee of Tenza's estate by making satisfactory arrangements for the immediate payment of the R100 000 to the trustee. If Bobby does so, he obtains transfer, and the outstanding debt under the mortgage is paid from the amount of R100 000. But if Bobby cannot make satisfactory arrangements, or does not wish to do so, and the trustee sells the property by public auction because he is not prepared to continue with the contract on its original terms, Bobby has a secured claim for repayment of the R80 000 which he has already paid in terms of the contract (with interest at the prescribed rate from the date of each payment which he has made). This secured claim is paid out of the proceeds of the auction, and ranks directly after the mortgage.

Activity 1

This activity will test your understanding of how the Alienation of Land Act operates.

Last year, Tenza paid the last instalment of the mortgage on his dwelling-house. He has now sold it to Bobby. The purchase price must be paid in three instalments of R100 000 each, two of which are payable this year, and the third next year. Before receiving transfer of the property, Bobby has since sold the house to Cynthia. Tenza's estate has recently been sequestrated, and he has not yet transferred the property to Bobby. Assume that the contract between Bobby and Cynthia falls under chapter II of the Alienation of Land Act.

- (1) In this set of facts, who is the intermediary, and who is the remote purchaser?
- (2) Indicate the steps that should be taken, and by whom, to notify the relevant parties of the right to obtain transfer of the dwelling-house.

- (3) Tenza lets his house to Bobby. Two months later, Tenza's estate is sequestered. What is the effect of sequestration on this lease, and what steps should the trustee take? How would your answer differ if a mortgage bond had been registered in favour of Payback Bank before the contract of lease was concluded? And what would the effect of the sequestration be on the lease of a horse by Tenza to Bobby? (17)
- (4) Tenza, the registered owner of a plot of land, sold it to Bobby for R200 000, R50 000 of which was payable immediately, and the rest six months later. Bobby paid Tenza the R50 000 and obtained possession of the property. Because Tenza failed to give transfer of the property in the Deeds Office, however, Bobby issued summons against him. Shortly afterwards, Tenza's estate was sequestered. Advise Bobby with regard to the effect of the sequestration of Tenza's estate on the contract. (11)
- (5) Define the "contract" as governed by chapter II of the Alienation of Land Act 68 of 1981. (4)
- (6) Tenza owns a dwelling-house and a sectional title unit. He is thinking of selling them and purchasing a shooting range owned by the state. He seeks your advice on whether chapter II of the Alienation of Land Act 68 of 1981 applies to any of these items of property. (4)
- (7) Tenza sold and delivered his car to Bobby for R25 000, the price to be paid in instalments over three months, and the ownership of the car to remain vested in Tenza until full payment of all the instalments. Bobby has paid two instalments when Tenza's estate is sequestered. Bobby insists on receiving ownership of the car against payment of the last instalment. The trustee refuses to cooperate. Advise Bobby with regard to the two opinions held on the effect of the sequestration of Tenza's estate on the transaction. (9)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) The general rule is that the sequestration of an employee's estate does not terminate the contract of employment.
- (2) According to Voet 17.2.17, the agreement of mandate between Tenza and Kennedy terminates on the sequestration of Kennedy's estate. It is not clear, though, whether the sequestration causes the implicit revocation of Kennedy's authority to perform juristic acts. On the basis that there is no such implicit revocation Kennedy has authority to find a buyer for Tenza's house. This proposition is based on the assumption that the mandatary (Kennedy), though instrumental in concluding the juristic act (finding a buyer for Tenza's house), is not a party to the resultant legal relationship (a contract of sale between Tenza and Matthew).

- (3) The sequestration of the estate of the lessor (Tenza) has no effect on the lease of the **immovable property**: the parties' obligations continue, and must be performed. In general, the trustee of Tenza's estate is not entitled to repudiate the contract of lease with Bobby.

The trustee will, however, have to realise the assets of the estate, including the house. In doing so, he must offer the property for sale subject to the lease. This obligation flows from the doctrine "huur gaat voor koop", as a result of which the lessee of immovable property acquires a real right in respect of the property.

The registration of the mortgage bond created a real right of security in favour of Payback Bank. This real right is older than the real right enjoyed by Bobby as a result of the doctrine of "huur gaat voor koop". The trustee must initially offer the property for sale subject to the lease. If the highest bid does not cover the amount due to the holder of the prior real right (here the mortgagee, Payback Bank), the trustee is compelled to repudiate the lease. At the request of the mortgagee, the trustee must then offer the property for sale free of the lease. Bobby will then have a concurrent claim against Tenza's insolvent estate for damages in respect of loss sustained because of the breach of contract.

Because the doctrine of "huur gaat voor koop" does not apply to the lease of **movable** property the trustee enjoys his general common-law election to uphold or to repudiate the contract of lease of a horse. If he decides to continue the contract the parties' obligations continue, also. In the more likely event that he decides to repudiate the contract, however, he may reclaim the horse from Bobby and sell it. Bobby is then left with a concurrent claim against the insolvent estate for damages.

- (4) Because the purchase price is not payable in more than two instalments over a period of more than a year, the Alienation of Land Act 1981 is not applicable and this question must be decided according to the general principles of the common law. Although Bobby occupies the land, the right of ownership still vested in Tenza at his sequestration and now vests in the trustee. Acting in the best interests of Tenza's creditors the trustee may elect whether to uphold or to repudiate the contract of sale. Bobby is not entitled to demand transfer of the property, even if the full price was paid before sequestration. If the trustee elects to uphold the contract Bobby will in due course receive transfer.

However, if the trustee decides to repudiate the contract (because he considers that the property can be sold for more than R200 000 in favour of the insolvent estate) Bobby may not demand transfer of the property. Bobby is then left with a concurrent claim against the insolvent estate for the repayment of the R50 000 already paid, and also for the loss sustained as a result of the breach of contract.

- (5) A "contract" is defined in section 1 of the Alienation of Land Act 68 of 1981 as a sale of land (as defined) in which the purchase price is payable in more than two instalments over a period exceeding one year.
- (6) Because chapter II of the Alienation of Land Act 68 of 1981 applies to land used or intended to be used mainly for residential purposes it does apply to the sale of a dwelling-house, and also to a unit as defined in the Sectional Titles Act 95 of 1986

(s 1 of the Alienation of Land Act, definition of "land"). But it does not apply to other land or land sold by the state.

- (7) Section 1 of the National Credit Act 34 of 2005 defines an "instalment agreement" as follows:

"instalment agreement" means a sale of movable property in terms of which-

- (b) all or part of the price is deferred and is to be paid by periodic payments;
- (b) possession and use of the property is transferred to the consumer;
- (c) ownership of the property either-
 - (i) passes to the consumer only when the agreement is fully complied with; or
 - (ii) passes to the consumer immediately subject to a right of the credit provider to re-possess the property if the consumer fails to satisfy all of the consumer's financial obligations under the agreement; and
- (d) interest, fees or other charges are payable to the credit provider in respect of the agreement, or the amount that has been deferred;

The present agreement is an instalment agreement: a movable (Tenza's car) was sold against payment of R25 000 in instalments over three months, and Bobby did not become owner of the car on its delivery to him.

Opinions are divided on the effect of the sequestration of Tenza's estate on the transaction. According to the opinion favourable to Bobby, if he continues to fulfil his contractual obligations the trustee has no right to repudiate the contract and vindicate the car. By paying the third instalment Bobby would obtain ownership of the car.

However, the better view, which favours the trustee, is that this problem falls within the scope of the general rule that the trustee may elect whether to uphold or to repudiate the contract. If the trustee decides to repudiate the contract, as he seems to have done here, he may vindicate (recover possession of) the car by means of the *rei vindicatio*, because the car remains part of Tenza's estate. Bobby has a concurrent claim for damages for breach of contract against the insolvent estate.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 11

UNCOMPLETED CONTRACTS AND LEGAL PROCEEDINGS NOT YET FINALISED

In this study unit, we shall mainly examine the purchase of goods in terms of an instalment agreement as defined in the National Credit Act 34 of 2005. We shall also briefly discuss a transaction on an exchange and an agreement on an informal market, in terms of the Insolvency Act.

After completing this study unit you should be able to

- define an instalment agreement
- explain the effect of sequestration of the **purchaser's** estate on the purchase of goods under an instalment agreement
- describe the effect of sequestration on
 - a transaction on an exchange
 - an agreement on an informal market
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly 7.2.8 to 7.2.10.

Omit Hockly 7.2.11 and 7.3.

7.2.8 Purchase of goods in terms of instalment agreement

In everyday language, an instalment agreement is also known as a hire-purchase agreement. It deals with movable goods sold on credit. That is, the goods are delivered immediately, but payment takes place only at some future date (usually in instalments over a future time period). Also, the general rule applicable to credit purchases (namely, that ownership passes on delivery) is expressly excluded by agreement. The parties agree that ownership will pass only at a later stage (usually on payment of the full purchase price). The seller therefore remains the owner until the agreed date arrives. Should the **seller** now become insolvent the purchaser is in the same weak position as a lessee of movable goods where the lessor becomes insolvent (see Hockly 7.2.7(iii)).

For the sake of completeness, we will set out the definition of “instalment agreement” in section 1 of the National Credit Act 34 of 2005 for you. Section 1 of that Act defines an “instalment agreement” as follows:

- “instalment agreement” means a sale of movable property in terms of which-
- (a) all or part of the price is deferred and is to be paid by periodic payments;
 - (b) possession and use of the property is transferred to the consumer;
 - (c) ownership of the property either-
 - (i) passes to the consumer only when the agreement is fully complied with; or
 - (ii) passes to the consumer immediately subject to a right of the credit provider to re-possess the property if the consumer fails to satisfy all of the consumer’s financial obligations under the agreement; and
 - (d) interest, fees or other charges are payable to the credit provider in respect of the agreement, or the amount that has been deferred;

Section 84 of the Insolvency Act applies where the **purchaser** becomes insolvent. The effect of section 84 is that the seller loses his right of ownership and in return acquires a hypothec over the goods for the outstanding purchase price. He is then in the same position as a pledgee (see Hockly 15.2.4).

We now move to consider section 84(2) of the Insolvency Act. Consider the following example of the application of section 84(2): Prior to the sequestration of Tenza’s estate he purchased a motor vehicle from City Motors in terms of a contract to which section 84 applies. Because he could not meet his instalments he returned the vehicle to City Motors within a month prior to the sequestration of his estate. At that stage, the motor vehicle was worth R40 000. The insolvent still owed R10 000 of the purchase price at the time that the vehicle was returned. The trustee may now claim R30 000 from City Motors (ie, the value of the vehicle minus the outstanding balance of the purchase price). The trustee will naturally rely on section 84(2) only if the value of the goods is greater than the outstanding purchase price. Only then will it be in the interest of the creditors of the estate.

Note the following important difference between the operation of section 84(1) and the operation of section 84(2): Under section 84(1), the hypothec created by statute arises automatically, by operation of law. Neither the seller nor the purchaser nor the trustee has any choice on whether that hypothec will be created or not. So, in relation to section 84(1), do not make the mistake of mentioning the trustee’s election at common law. In the situation dealt with by section 84(1) the trustee has no election whether to continue with, or to repudiate, the instalment agreement”. The instalment agreement simply terminates (comes to an end) by operation of law.

Now we turn to examine section 84(2). Here, the trustee does have a choice: note the words “the trustee may demand” in the last paragraph of Hockly 7.2.8. As Hockly points out, “Here the legislature clearly intended to enable the trustee to reclaim the property for the benefit of concurrent creditors”.

There is a further mistake that you must avoid when studying section 84(1). Note that when the hypothec is created by operation of law **the movable property concerned falls into the insolvent estate of the purchaser, and ownership of the movable passes to the trustee of that insolvent estate and so vests in that trustee**. Do not make the mistake of thinking that the movable property vests in the insolvent purchaser.

7.2.9 Transaction on exchange

Note the special definitions of “exchange” and “market participant” in section 35A of the Insolvency Act.

7.2.10 Agreement on informal market

Note that section 35B applies to an “agreement” as specially defined in section 35B itself.

SELF-TEST QUESTIONS

- (1) Which section of which statute defines the term “instalment agreement”? (2)
- (2) Which section of which statute contains the provisions dealing with the effect of the sequestration of the purchaser’s estate on an instalment agreement. (2)
- (3) Define an instalment agreement. (10)
- (4) In January, Bobby sells and delivers his car to Tenza for R30 000, which Tenza is obliged to pay in three monthly instalments of R10 000 each in January, February, and March. It is a term of the agreement that the ownership of the car will pass to the purchaser only after the purchase price has been paid in full. Tenza’s estate is sequestrated in February, after he has paid R10 000 towards the price of the car. Tenza is still in possession of the car. Advise Bobby on the effect of the sequestration on the contract. (6)
- (5) Tenza bought a movable from Bobby under an instalment agreement. Two weeks before Tenza’s estate was sequestrated he returned the movable to Bobby. At that stage, Tenza had paid R80 of the R100 owing to Bobby under this transaction. Explain what the trustee of Tenza’s insolvent estate may now do in respect of this transaction. (6)
- (6) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

The seller acquires no hypothec under section 84(1) of the Insolvency Act if the seller, prior to sequestration, cancelled the instalment agreement on account of the buyer’s failure to pay an instalment and the purchaser did not obtain the required reinstatement.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) Section 1 of the National Credit Act 34 of 2005 defines the term “instalment agreement”.
- (2) Section 84 of the Insolvency Act contains the provisions dealing with the effect of the sequestration of the purchaser’s estate on an instalment agreement.
- (3) An instalment agreement is a sale of movable property in terms of which
 - (a) all or part of the price is deferred and is to be paid by periodic payments;
 - (b) possession and use of the property is transferred to the consumer;
 - (c) ownership of the property either-
 - (i) passes to the consumer only when the agreement is fully complied with;
or
 - (ii) passes to the consumer immediately subject to a right of the credit provider to re-possess the property if the consumer fails to satisfy all of the consumer’s financial obligations under the agreement; and
 - (d) interest, fees or other charges are payable to the credit provider in respect of the agreement, or the amount that has been deferred;
- (4) This contract of sale is an agreement under which a movable (Bobby’s car) was sold and delivered against payment of a price that was to be paid by periodic payments, and the purchaser (Tenza) did not become owner of the car on delivery to him. It was therefore an instalment agreement (s 1 of the National Credit Act 2005).

On the sequestration of Tenza’s estate, Bobby acquires a hypothec over the car to secure the R20 000 balance outstanding under the agreement (s 84(1) of the Insolvency Act). Because no one may have a hypothec over his own property, ownership in the car passes from Bobby to Tenza’s insolvent estate by operation of law. Therefore Bobby loses his right of ownership in the car and at the same time becomes a creditor with a hypothec over the car. Bobby may require the trustee to deliver the car to him; Bobby will then be deemed to hold it as security for his claim, and be entitled as a secured creditor to realise it in accordance with section 83 of the Act.

- (5) Because Tenza returned the movable to Bobby within one month before the sequestration of Tenza’s estate the trustee may demand that Bobby deliver to him the movable or its value at the date of return. This demand is subject to the trustee’s paying the creditor (Bobby) the difference between the total amount payable under the transaction (R100) and the total amount actually paid under it (R80), or the creditor’s deducting the difference from the value of the movable (as the case may be). In these circumstances, Parliament intended the trustee to be able to reclaim the movable for the benefit of the concurrent creditors, because the outstanding R20 is disproportionately small compared with the value of the article returned (R100).

- (6) This statement is true. Section 84(1) of the Insolvency Act presupposes an agreement still in force: the section has no application if the seller, prior to sequestration, cancelled the agreement on account of the buyer's default and the buyer did not obtain reinstatement in terms of the National Credit Act 2005 (*ABSA Bank Ltd v Cooper NO and others* 2001 (4) SA 876 (T)). See Hockly 7.2.8. In the present case, the buyer's late payment of an instalment was a breach of contract, and the type of breach was default by the purchaser. Also, the seller, prior to the sequestration of the purchaser's estate, cancelled the agreement because of this default by the purchaser. Nor did the purchaser obtain reinstatement in terms of the National Credit Act 2005. So section 84(1) of the Insolvency Act does not apply to these facts, and the hypothec created in terms of section 84(1) does not arise in this case.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Omit Hockly chapter 8 on the preservation of the estate pending the trustee's appointment.

Study unit 12

MEETINGS OF CREDITORS AND PROOF OF CLAIMS

In this study unit, we deal with meetings of creditors. These meetings, although they may seem to be judicial, are essentially administrative.

After completing this study unit you should be able to

- name the different types of creditors' meetings
- define "creditors" in relation to creditors' meetings
- state the timing, purpose(s), and calling of the different types of creditors' meetings
- explain the general procedure of creditors' meetings as regards date and venue, presiding officer, record keeping, and privilege of statements made at meetings
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly 9.1 to 9.1.5.

Omit Hockly 9.2 to 9.3.6.

9.1 Meetings of creditors

There are four types of creditors' meetings:

- (1) the first meeting
- (2) the second meeting
- (3) a special meeting
- (4) a general meeting

9.1.1 First meeting

After receiving a final sequestration order the Master must immediately convene (cause to come together) a first meeting of creditors by notice in the *Government Gazette*. The purpose of this meeting is to enable creditors to prove their claims and to elect a trustee of the insolvent estate.

9.1.2 Second meeting

After the first meeting the Master must set a date for the second meeting of creditors. Note that the Master does not convene this meeting; instead, the elected trustee convenes it by giving notice in the *Government Gazette* and one or more newspapers circulating in the district in which the insolvent resides or has his principal place of business. The purpose of this second meeting is to enable creditors to prove their claims, to receive the trustee's report, and to give the trustee directions regarding the administration of the estate.

9.1.3 Special meeting

A special meeting may be called for proving claims or interrogating an insolvent.

A special meeting for proving claims must be convened by the trustee if so required by an interested person, provided that that person tenders payment of all expenses to be incurred in connection with that special meeting.

As regards a special meeting for interrogating the insolvent, the trustee may convene this meeting whenever required to do so by a creditor who has proved a claim against the estate. But the Master's consent to the calling of such a special meeting is required. The trustee must also give notice of this meeting in the *Government Gazette*.

9.1.4 General meeting

A general meeting may be called by the trustee for the purpose of giving him instructions on any matter relating to the administration of the estate. This meeting must be called if so required by the Master or by creditors representing one-fourth of the value of all proved claims.

9.1.5 General provisions relating to meetings

In this regard, we examine the technicalities of convening a meeting, particularly the date and venue of meetings, the presiding officer, the record of the proceedings, and the privileged nature of statements made in the meeting.

Activity 1

You are the trustee of Tenza's insolvent estate. You have discovered that Tenza paid Bobby, Cynthia, and Donald within six months of the sequestration of his estate, for reasons that remain unclear. You wish to question Bobby, Cynthia, and Donald about these payments. On what occasions could they be questioned?

Feedback

Because a trustee has been appointed in respect of Tenza's insolvent estate the first meeting of creditors (at which the trustee is elected) has already been held (see Hockly 9.1.1). Bobby, Cynthia, and Donald could still be interrogated at a second meeting or a general meeting of creditors (s 65(1)). But they could not be questioned at a special meeting called for the sole purpose of interrogating Tenza (see Hockly 9.1.3(ii)).

SELF-TEST QUESTIONS

- (1) Name the various types of creditors' meetings. (4)
- (2) State one similarity and two differences between a first meeting of creditors and a second meeting of creditors. (5)
- (3) State three requirements for convening a special meeting of creditors to interrogate the insolvent. (3)
- (4) State the law on the interrogation of witnesses at a general meeting. (2)
- (5) Briefly state the law and practice concerning the venue of creditors' meetings. (2)
- (6) Who presides over a meeting of creditors? (5)
- (7) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

If a creditor considers that the minutes of a creditors' meeting do not adequately show that, in that meeting, the insolvent admitted inheriting a house, that creditor may give evidence himself before the Master to prove the admission made by the insolvent at the creditors' meeting.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) The first meeting, the second meeting, a special meeting, and a general meeting.
- (2) At both meetings, creditors may prove their claims against the estate. One difference is that the first meeting is convened by the Master, but the second is convened by the trustee. A second difference is that at the first meeting the creditors elect the trustee, but at the second they receive his report and give him directions for the administration of the estate.
- (3) The Master must consent to the meeting. Due notice of the meeting must be published in the *Government Gazette*. And only the insolvent may be interrogated.
- (4) A general meeting may not be convened solely for the purpose of interrogating witnesses. But witnesses may be interrogated at a general meeting properly called "for the purpose of giving the trustee directions".
- (5) The Insolvency Act merely requires that meetings be held in a place accessible to the public. In practice, meetings are held at the Master's office or the magistrate's office.

- (6) If the district has a Master's office the Master or the person in the public service designated by him presides. If the district lacks a Master's office the local magistrate or the person in the public service designated by him presides. If the meeting is held in a district which lacks a Master and someone other than the magistrate presides at the meeting the presiding officer must record why the magistrate did not preside over the meeting.
- (7) This statement is true. The minutes of the creditors' meeting constitute prima facie evidence of the proceedings (s 68(1) of the Insolvency Act). The minutes are not incontrovertible (incontestable) proof, and there is no bar to the leading of extraneous evidence to establish that the minutes do not correctly record what transpired at the meeting and what did, in fact, occur (*Pine Village Home Owners Association Ltd & others v The Master and others* 2001 (2) SA 576 (SE) 580). See Hockly 9.1.5(iii). Accordingly, the creditor in question may give evidence himself about what happened at the creditors' meeting. This evidence is extraneous because it is not comprised in, and does not form part of, the minutes of the meeting.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 13

THE ELECTION OF THE TRUSTEE

In this study unit, we deal with the election and appointment of the trustee. The Insolvency Act provides that some persons may not be appointed as trustees to **any estate**, and that some persons may not be appointed to **a particular estate**.

After completing this study unit you should be able to

- discuss the election and appointment of a trustee
- explain the disqualifications for being a trustee
- describe the vacation of, and removal from, office of the trustee
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly 10.1 to 10.3.3.

Omit Hockly 10.4 to 10.7.

10.1 Election and appointment

In all final appointments, the ultimate responsibility is with the Master. In terms of the Insolvency Act, the Master has the power to confirm, or to refuse to confirm, the appointment of any elected or nominated person.

10.1.1 Election

Activity 1

This activity is aimed at the practical application of the principles for the appointment of trustees.

Consider the following example: three creditors have proved their claims against an insolvent estate. Themba has a claim of R10 000, Benny a claim of R15 000 and Caroline a claim of R30 000. Themba nominates Xolane as trustee, and Caroline nominates Zanele. Themba and Benny vote for Xolane, and Caroline votes for Zanele.

Who will be appointed as trustee?

Feedback

In this instance, Xolane will have a majority in number, and Zanele a majority in value. Provided one person is not disqualified from being a trustee, both will be appointed as trustees.

10.1.3 Refusal to appoint

Here we deal with the grounds on which the **Master** may refuse to appoint a person as a trustee.

Activity 2

Name the grounds upon which the Master may refuse to appoint a person as a trustee.

Feedback

The Master may refuse to confirm the election of a person if

- (1) he was not properly elected
- (2) he is disqualified from being a trustee
- (3) he has failed to give the required security
- (4) in the opinion of the Master, he should not be appointed as trustee to the estate in question

Remember that a subjective discretion is exercised in the last instance, where the Master decides that a person should not be appointed as a trustee.

10.1.4 Objection to appointment or refusal to appoint

Here we deal with **any interested party's** objection to the appointment of a trustee.

10.2 Persons disqualified from being trustee

Hockly points out that although some persons are incapable of being appointed as trustees, others are disqualified from acting as trustees of some estates.

The **disqualifications** are divided into **absolute** disqualification and **relative** disqualification.

10.2.1 Absolute disqualification

Note that as a result of these absolute grounds for disqualification these persons may not act as trustee of **any** estate.

One of these absolutely disqualified persons is a former trustee who has been disqualified in terms of section 72. This section deals with a person whose estate is sequestrated while indebted to an estate of which he was a trustee for a sum of money which he misappropriated from that estate.

Activity 3

Find a common factor among the first four grounds mentioned in Hockly 10.2.1. There is also a common factor in the last five grounds mentioned in Hockly. Use these two factors as headings, and make a summary of the absolute grounds for disqualification from being a trustee of an insolvent estate under these two headings.

Feedback

The grounds are listed in Hockly 10.2.1. Note that the first four grounds deal with the capacity to act or the capacity to act personally, while the last five all deal with grounds in which an element of dishonesty is present. If you put the grounds for absolute disqualification under these two general headings they will be easier to memorise.

10.2. 2 Relative disqualification

Note that as a result of a relative ground for disqualification such a person cannot be a trustee of a **specific** insolvent estate. This prohibition differs from the absolute grounds for disqualification where such a person may not be a trustee of any insolvent estate whatsoever.

Activity 4

Tenza's estate is sequestrated. Ben would like to be the trustee of Tenza's insolvent estate. Ben is the nephew of Tenza's wife, Zodwa (ie, Ben is the son of Tenza's brother-in-law). Will Ben be disqualified from being the trustee because he and Tenza are related by affinity in the third degree? You can work out the answer by setting out the affinity in a diagram.

Feedback

Your diagram may set out the relationship as follows:

Zodwa's parents

2nd degree

1st degree

Zodwa's brother

Zodwa_____ Tenza

3rd degree

Ben

From this diagram it appears that Zoda's parents are removed by one degree of affinity from Tenza. Zoda's brother is removed by two degrees of affinity from Tenza. Ben is removed by three degrees of affinity from Tenza. So Ben will not be able to act as trustee of Tenza's insolvent estate.

10.3.1 Vacation of office

There are certain circumstances in which a trustee must vacate his office, and they are discussed in this paragraph.

Activity 5

Why must a trustee who has been found guilty of offences such as theft and fraud be removed from office?

Feedback

Remember that the assets of the insolvent debtor vest in the trustee and that he has to gather and preserve the assets of the insolvent debtor, realise them, and divide the proceeds among the creditors according to the provisions of the Act. Holding such an office is incompatible with conduct where an element of dishonesty was present.

10.3.2 Removal from office by Master

One of the grounds on which the Master may remove a trustee from office is if the majority of creditors has requested in writing that the trustee be removed. This majority must be a **majority both in number and in value**.

10.3.3 Disqualification, or removal from office, by court

The effect of *Fey NO and Whiteford NO v Serfontein and another* 1993 (2) SA 605 (A) is that there are two ways in which to remove a trustee from office on the grounds of misconduct, namely:

- (1) The Master may remove the trustee from office in terms of section 60(e) of the Insolvency Act.
- (2) The court may remove the trustee from office in terms of the **common law**. The Insolvency Act itself does not grant the court the authority to remove a trustee on the grounds of misconduct.

SELF-TEST QUESTIONS

- (1) There are four creditors with proved claims against an insolvent estate. Themba has a claim of R20 000, Benny a claim of R5 000, Caroline a claim of R40 000, and Donald a claim of R5 000. Themba nominates Xolane as a trustee, and Caroline nominates Zanele. Themba, Benny and Donald vote for Xolane, and Caroline votes for Zanele.

Answer the following questions:

- (a) Who will be appointed as trustee?
- (b) Would it make any difference to your answer above if it later appears that Xolane will be emigrating to Australia in two months' time?

(5)

(2) The following persons would very much like to act as the trustee of Tenza’s insolvent estate:

- (b) Tony, Tenza’s old university friend
- (c) Jane, Tenza’s granddaughter
- (d) Kate, Tenza’s bookkeeper
- (e) Harry, a 17-year-old law student
- (f) Lizzy, Tenza’s partner
- (g) Freddie, South Africa’s ambassador in Finland
- (h) Gideon, the son of Tenza’s cousin
- (i) Siphon, a friend of Tenza whose estate was sequestrated two years ago
- (j) Oupa, an attorney who specialises in insolvency law and who was removed from the roll of practising attorneys as a result of a shortage in trust moneys
- (k) Zandile, who is unemployed

Indicate whether the following are persons who are absolutely or relatively disqualified or not disqualified from acting as the trustee of Tenza’s insolvent estate by filling in their names in the correct columns:

ABSOLUTE DISQUALIFICATION	RELATIVE DISQUALIFICATION	NO DISQUALIFICATION

(20)

(3) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

If the creditors have elected a trustee unlawfully the Master may exercise his discretion to appoint this person as the trustee if he was the only candidate nominated by the creditors present and entitled to vote at the creditors’ meeting.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) (a) In this instance, Xolane will have a majority in number and Zanele a majority in value. Both will be appointed as trustees provided one is not disqualified from acting as a trustee.
- (b) If a person resides abroad this factor forms an absolute ground for disqualification to act as trustee of an insolvent estate. If Xolane emigrates to Australia he will not be able to act as trustee. Only Zanele may be appointed as trustee.
- (2) Harry, Siphon, Freddie and Oupa will be absolutely disqualified to act as the trustee of Tenza's insolvent estate: Harry is a minor, Freddie lives abroad, Siphon is insolvent, and Oupa was removed from a position of trust as a result of misconduct and was possibly also found guilty of theft.

Jane, Kate, and Lizzy will not be able to act as trustee of Tenza's insolvent estate based on the relative grounds for disqualification: Jane is related to Tenza within the third degree, Kate is Tenza's bookkeeper, and Lizzy has an interest in his (Tenza's) insolvent estate, being his partner.

There are no grounds for refusing the appointment of Tony, Gideon, and Zandile: Tony is merely a friend, the relationship of affinity between Gideon and Tenza is removed by more than three degrees, and the fact that Zandile is unemployed is irrelevant.

- (3) This statement is false. If the creditors have elected a trustee unlawfully the Master is obliged not to confirm the election and to convene a creditors' meeting to elect another trustee (*Sabie Mediese Sentrum (Edms) Bpk v Die Meester en andere* 1977 (4) SA 389 (T)). See Hockly 10.1.3. The Master has no discretion to appoint this person as the trustee if he was the only candidate nominated by the creditors present and entitled to vote at the creditors' meeting.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Omit Hockly chapter 11 on the duties and powers of the trustee.

Study unit 14

IMPEACHABLE DISPOSITIONS – INTRODUCTION, AND DISPOSITIONS MADE NOT FOR VALUE

Before his estate was sequestrated Tenza made various dispositions of his assets. In other words, he paid certain sums of money to other persons, and he got rid of certain items of property to other persons. The trustee of Tenza's insolvent estate wishes to know whether he or she could attack these transactions by Tenza as impeachable dispositions under the relevant principles of insolvency law. (Note that the word "disposition" has a special definition in s 2 of the Insolvency Act. The word "impeachable" means that the validity of these dispositions may be challenged or attacked.)

What is the purpose of relying on the law of impeachable dispositions? If the trustee can challenge these dispositions successfully the relevant assets will be recovered, and may then be sold (realised). The proceeds of those assets will then form part of the free residue of the insolvent estate (see Hockly 16.3.2). This free residue will be distributed among the creditors according to the order of preference (see Hockly 16.3.2). So the more money there is in the free residue the higher will be the dividend payable to the ordinary, concurrent creditors. Now, in this study unit 14 you will begin to examine the law of impeachable dispositions, the means by which the trustee can recover property that the debtor got rid of before his or her estate was sequestrated.

After completing this study unit you should be able to

- state the elements of the term "disposition" in section 2 of the Insolvency Act
- list five kinds of dispositions which may be set aside, distinguishing between the four types which may be set aside under the Insolvency Act, and the one which may be set aside in terms of the common law
- list and apply the requirements for the setting aside of a disposition without value in terms of section 26 of the Insolvency Act
- summarise the facts of the prescribed case of *Estate Wege v Strauss* 1932 AD 76, state the main principles in that case which are relevant to impeachable dispositions, and apply those principles to a similar set of facts
- explain and apply the exception to section 26 of the Insolvency Act
- explain the application of section 26(2) of the Insolvency Act with regard to the proof of claims by the person receiving the benefit of the disposition without value
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

The box containing the compulsory study materials for study unit 14 appears on the following page.

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly chapter 12 to just before 12.2.2.

Also study the following:

***Estate Wege v Strauss* 1932 AD 76 (case [36] in Loubser)**

As you have seen (in Hockly 1.2), one of the main objectives of the sequestration procedure is to ensure that the general body of creditors is dealt with in an orderly and equitable fashion. Impeachable dispositions are juristic acts which the insolvent executed prior to the sequestration of his or her estate, and which had the effect of adversely disturbing the contemplated equitable treatment of the creditors, or which had the effect of unfairly prejudicing the general body of creditors. The Insolvency Act and the common law of insolvency empower the trustee to set aside these juristic acts in order to restore the balance.

12.1 Meaning of “disposition”

Study the definition of “disposition” in section 2 of the Insolvency Act carefully. This technical definition controls four sections of the Insolvency Act which provide for impeachable dispositions to be set aside. Those four sections are the following:

- (1) section 26 (dispositions without value)
- (2) section 29 (voidable preferences)
- (3) section 30 (undue preferences)
- (4) section 31 (collusive dealings before sequestration)

All four of these sections mention the words “disposition” and “dispose”. So the definition of these words in section 2, as it has also been interpreted by the courts (cf Hockly 12.1), determines whether sections 26, 29, 30 and 31 of the Insolvency Act apply to a particular set of facts.

You may be wondering what is meant by some of the transactions listed in the special part of the definition of “disposition” in section 2. Here are some short explanations to help you:

- (1) “sale”: A contract by which one party (the seller) agrees to transfer or deliver a thing to another party (the buyer) in return for the payment of a sum of money (the purchase price).
- (2) “lease”: A contract by which one party (the lessor) provides the use of a thing to another party (the lessee) in return for the payment of a sum of money (the rent).
- (3) “mortgage”: We shall use the example of a special mortgage bond over immovable property (such as a house). Suppose that the house owner wishes to borrow money from the bank. The bank wishes to be sure that it will be repaid the loan if the borrower

(the house owner) becomes insolvent. So the house owner, as the mortgagor, agrees to provide security to the bank (the mortgagee) for the performance of the mortgagor's obligations under the loan. The mortgagor provides this security by passing a mortgage bond over his or her immovable property. This bond is registered against the property in the Deeds Office. If the mortgagor does not perform his or her obligations as promised under the loan agreement the mortgagee may have the property sold and recover the amount of the outstanding debt from the proceeds of the property.

- (4) "pledge": Suppose that A borrows money from B. As security for the repayment of this loan A may also agree to provide B with a pledge. A therefore hands over his or her movable property (such as a watch) to B, who then keeps A's watch. If A does not pay back the loan B may have A's watch sold and recover the outstanding amount owed from the proceeds of the watch.
- (5) "delivery": The transfer of possession of a movable item.
- (6) "payment": payment may take various forms, and the word is often used in the sense of paying a debt.
- (7) "release": Under a release, the parties agree that a pre-existing duty is discharged before it has been performed in full.
- (8) "compromise": The parties to the agreement of compromise settle a dispute or an uncertain issue.
- (9) "donation": One party (the donor), who is under no obligation to do so, agrees to give another party (the donee) something for free. An example of such a contract of donation is a birthday present.

After this list in section 2, you will notice the phrase "or any contract therefor". This phrase means that any contract for any of the transactions previously listed in the definition (ie, sale, lease, mortgage, pledge, delivery, payment, release, compromise, or donation) also falls within the scope of the definition. So, for example, a contract for lease will be a "disposition" as defined in section 2. The phrase "or any contract therefor" is not restricted to the last type of contract mentioned in the list, namely donation (see *Langeberg Koöperasie Bpk v Inverdoorn Farming and Trading Company Ltd* 1965 (2) SA 597 (A) at 602-603). The phrase "or any contract therefor" thus widens the scope of the definition of "disposition" in section 2, and also the scope of the various sections controlled by that definition (ie, ss 26, 29, 30, and 31 of the Insolvency Act).

In the discussion in Hockly 12.1, you will also find a reference to the contract of suretyship. This form of contract depends on the existence of a main obligation of debt between a debtor and a creditor. Under the contract of suretyship, the surety agrees to be liable to the creditor for the performance of all, or a part of, the debtor's obligation or obligations to the creditor. If the debtor does not perform as promised the creditor may then claim some or all of the relevant performance from the surety.

While studying the definition of "disposition" in section 2 of the Insolvency Act you must note that a disposition made in compliance with an order of court is not a "disposition" for the purposes of the statutory provisions relating to impeachable dispositions. A disposition made in compliance with an order of court has been **excluded** in terms of the definition because the debtor does not make the disposition voluntarily. In these circumstances the debtor has been compelled to do so by an order of court. The decision in *Swadif (Pty) Ltd v Dyke NO* 1978 (1) SA 928 (A) indicates that if the debtor has not performed in terms of the court order the debt on which the order is based remains a disposition, and if the

Name of disposition	Set aside under the Insolvency Act	Set aside under the common law
Dispositions made not for value		
Voidable preferences		
Undue preferences		
Collusive dealings before sequestration		
Disposition in fraud of creditors		

Feedback

Name of disposition	Set aside under the Insolvency Act	Set aside under the common law
Dispositions made not for value	Dispositions made not for value (s 26): examined in study unit 14	
Voidable preferences	Voidable preferences (s 29): examined in study unit 15	
Undue preferences	Undue preferences (s 30): examined in study unit 15	
Collusive dealings before sequestration	Collusive dealings before sequestration (s 31): examined in study unit 15	
Dispositions in fraud of creditors		Dispositions in fraud of creditors. These dispositions are set aside by means of the <i>actio Pauliana</i> and will be examined in study unit 15.

12.2.1 Disposition made not for value

12.2.1(i) What must be proved

With regard to section 26 of the Insolvency Act 1936, note the **prescribed** case of *Estate Wege v Strauss* 1932 AD 76. This section deals with the predecessors of the current sections 26 and 29 of the Insolvency Act 1936 (ie, ss 24 and 27 of the repealed Insolvency Act 32 of 1916). As far as section 26 of the Insolvency Act 1936 is concerned, the following two points which were decided in the case are still of particular importance:

- (1) Payment of a wagering debt is not a disposition without value merely because the party who received payment gave nothing in return. The “value” of the other party lies in the fact that this party would have paid, if he or she had lost the wagering bet. Although a wagering debt cannot be enforced in a court of law it creates a “natural obligation” and is not on the same level as an agreement which is altogether void.
- (2) To establish whether adequate value was received one has to look at the circumstances which existed **at the time of the transaction**. Should A, for example, purchase shares in a company from B at a price which at the conclusion of the contract is more or less equal to the market value a later drastic reduction in the market value of the shares (eg, as a result of extensive damages suffered by the company concerned) will not result in A’s having made a disposition without value.

Activity 3

This activity will help you interpret the decision in the **prescribed** case of *Estate Wege v Strauss* correctly.

In this case, the trustees of the insolvent estate of Wege submitted that

- (1) a wagering contract is null and void
- (2) no value was received, because a payment which is made in terms of an invalid agreement cannot be regarded as value
- (3) the fact that a wagering agreement is unenforceable plays an important role

Summarise the court’s answer to each of the above arguments.

Feedback

- (1) The court held that a bet is not illegal at common law. Also, a bet is not null and void in the sense that it gives rise to no claim at all. However, the parties to the bet cannot enforce it in court. So the statement by the courts that a bet is null and void merely means that the courts will not assist parties to enforce a bet.
- (2) The court rejected the argument that no value was received, because a payment which is made in terms of an invalid agreement cannot be regarded as value. In reaching its decision the court held that the word “value” carries its ordinary meaning. Under a racing bet, the person placing the bet promises to pay money to the bookmaker if a certain horse loses, and the bookmaker promises to pay money if the horse wins. Each of these mutual promises is made in return for the other promise. Clearly, the bookmaker’s promise may be a valuable right or asset even though its value may be speculative.
- (3) The court held that the fact that the parties could not enforce a bet in a court did not mean that the promise to pay was of no value. The law does not regard a bet as being established on a base cause (in Latin, a *turpis causa*). It is neither illegal nor immoral to bet on horseraces. Horseracing is subject to regulations. The appeal court quoted the judge in the trial court, who indicated that even though the bookmaker’s promise could not be enforced in a court it could be enforced by other means which were just as effective. Under the rules of Tattersall’s, a bookmaker would lose his

rights as a member of Tattersall's if he failed to pay as promised. So the bookmaker had a powerful incentive to carry out his promise. In addition, under the rules of Tattersall's, the bookmakers' association guaranteed Wege's bets up to £500. If Wege won his bet he was therefore practically certain of obtaining his money.

Something extra for you to consider:

Do you know the history behind the word "Tattersall's"; in other words, the etymology of this word?

Searching the *TheFreeDictionary.com* dictionary on the World Wide Web, you will find the following definition (see <http://www.thefreedictionary.com/tattersall's>):

Tattersall's

(n.) A famous horse market in London, established in 1766 by Richard Tattersall, also used as the headquarters of credit betting on English horse races ...

On the website of the National Portrait Gallery in London you find the following entry for him (see <http://www.npg.org.uk/collections/search/person.php?search=ss&firstRun=true&sText=Richard+Tattersall&LinkID=mp04417>):

In 1766 Richard Tattersall, also known as "Old Tatt", founded *Tattersall's*, a horse auction mart near Hyde Park Corner. His honesty and business-like precision attracted the nobility and the chief members of the Jockey Club for whom, around 1779, he fitted up two rooms; these "subscription rooms" soon became a most important resort of the sporting world, and the centre from where all betting upon the turf was regulated. An original copy of the "Rules" from 1780 is now in the counting house at Tattersall's.

There are branches of Tattersall's in several countries.

12.2.1(ii) Exception to s 26 – disposition in terms of ANC

Section 27 of the Insolvency Act creates an exception to section 26. If the requirements of section 27 are met the trustee cannot set aside the disposition. Note that the letters "ANC" in the subheading of Hockly 12.2.1(ii) are the standard lawyer's abbreviation for "antenuptial contract". In the present context, the letters "ANC" do not refer to the African National Congress.

Activity 4

This activity will help you understand the exception to section 26 better. All the requirements of section 27 have to be met before that section may be raised successfully as a defence. If one of these requirements is not met, section 27 cannot apply, and so it does not support a defence. By making a list of these requirements of section 27 you can help yourself remember them all.

Read section 27 of the Act at the back of Hockly. Make a point-by-point exposition of this exception or defence.

Feedback

Now return to the text of Hockly 12.2.1(ii) and check your answer against the listed requirements. Ensure that your exposition covers the following questions:

(1) Who may raise this defence? (In other words, who should have received the benefit?)

To show you how to complete activity 4, we shall answer question (1) for you. The person who should have received the benefit must be the insolvent husband's wife, or the child born of the marriage between the husband and the wife.

(2) Against which type of disposition without value is the defence available?

(3) When must the disposition have taken place?

(4) How must the disposition have occurred?

(5) What must have occurred at least two years prior to sequestration?

12.2.1(iii) Beneficiary's right to share in estate limited

Section 26(2) of the Insolvency Act requires further comment. The general principle is that a disposition without value which is not "performed" does not create a provable claim against the estate. Consider the following example: in terms of a valid contract of donation, A undertakes to donate R10 000 to B. Immediately after the conclusion of the contract A's assets exceed his liabilities. It follows that the contract of donation itself cannot be set aside in terms of section 26. Before A pays the R10 000 to B, however, A's estate is sequestrated. Now B will not be able to prove a concurrent claim for R10 000 against A's insolvent estate. The fact that A's assets exceeded A's liabilities immediately after the conclusion of the contract will therefore not help B. B cannot prove any claim against the estate.

However, because suretyship and similar contracts are usually regarded as dispositions without value (see *Langeberg Koöperasie Bpk v Inverdoorn Farming and Trading Company Ltd* 1965 (2) SA 597 (A)), section 26(2) of the Insolvency Act used to create problems, especially for banks. At their insistence, section 26(2) was amended.

This amendment to section 26(2) illustrates that law sometimes results from influence exerted by certain persons, political parties, and interest groups or movements. You will see another such example of an amendment to the Insolvency Act when you study Hockly 16.3.2(v), which deals with the new section 98A of the Insolvency Act. Section 98A improved the position of employees, and it was inserted into the Insolvency Act at the insistence of the trade-union movement, a powerful force in contemporary South African politics and society.

Returning to section 26(2) of the Insolvency Act, we note that its provisions are now qualified as far as they have a bearing on dispositions without value "by means of suretyship, guarantee or indemnity". In terms of section 26(2) as it now reads, the creditor who ensured that the surety's assets sufficiently exceeded his or her liabilities at the time of granting the suretyship will therefore still have a provable claim against the estate of the insolvent surety if the principal debtor does not pay.

SELF-TEST QUESTIONS

- (1) Define the term “disposition”. (12)
- (2) Indicate whether the following transactions are (a) dispositions, and (b) whether a countervalue has been received in each instance:
- (i) A sold his car to B for its current market value.
 - (ii) C pledged a fur coat valued at R6 000 to D as security for a loan of R10 000.
 - (iii) E donates a bundle of old clothing to a charitable institution.
 - (iv) F sells her brand-new German vehicle to G for R50.
 - (v) H pays his judgment debt of R3 000 to I.
 - (vi) J lets her home to K.
 - (vii) L pays his account at M Pharmacy.
 - (viii) N binds himself as surety for P’s debt to O.

(16)

- (3) D’s estate is sequestrated on 3 January 2008. In June 2005, D handed over an amount of R3 000 to his friend F, who at that stage wished to travel overseas. Of this sum R1 000 was a gift, and the balance was a loan which was to be paid back by F in June 2007. When F wished to repay the money in June 2007, D said that he (F) could keep the money, because he (D) no longer wished the money to be repaid to him. The trustee of D’s insolvent estate wishes to know whether she may reclaim the R3 000, or part of it, from F, and what she would have to prove in these circumstances. F wishes to know what he could do to retain the money, or part of it. Explain the legal position to these people.

(8)

- (4) Bank B grants a loan of R10 000 to A, and C binds himself as surety towards the bank for the repayment of this loan. A fails to repay the loan. Bank B now wishes to hold C accountable as surety, but discovers that in the meantime C’s estate has been sequestrated. Explain whether Bank B may prove any claims against C’s insolvent estate on the basis of the suretyship.

(6)

- (5) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

If the trustee wishes to set aside a disposition without value under section 26 of the Insolvency Act, he or she must prove that the insolvent intended to prefer one of his or her creditors above another.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) “Disposition” means any transfer or abandonment of rights to property and includes a sale, lease, mortgage, pledge, delivery, payment, release, compromise, donation or any contract for this, but does not include a disposition in compliance with an order of the court. Ensure that your answer conveys the definition fully. It does not have to be

in the exact wording of section 2, but besides the general part it must refer to all the examples of dispositions mentioned in the definition.

- (2) All except (v) are dispositions. Countervalue is received in all cases except (iii), (iv), and (viii). In (iii), the amount of R50 is totally inadequate in comparison with the value of the vehicle, so that it cannot be considered as a countervalue. Suretyship is also a disposition without value. It is **INCORRECT** to think that because section 26(2) allows a claim against the estate in some circumstances, it would mean that the suretyship has taken place for value.
- (3) In effect, D donated R1 000 to F in June 2005, and R2 000 in June 2007. Both these donations could possibly be set aside as dispositions without value, but the requirements which would have to be proved by the trustee differ in one respect. With regard to both donations, the following two aspects must be proved by the trustee:
- (a) that a disposition was made by D to F
 - (b) that no countervalue was received for it.

The R1 000 was donated to F more than two years prior to the sequestration of D's estate. The trustee will therefore be able to set aside the disposition only if she can also prove that, immediately after the disposition, D's liabilities exceeded his assets (ie, that he was already insolvent at that time).

With regard to the R2 000 which was donated less than two years prior to sequestration the trustee need merely prove requirements (a) and (b) above. But if F can prove that D's assets exceeded his liabilities immediately after the donation (ie, that he was still solvent at that stage) he can ward off the claim for the setting aside of the disposition. Ensure that you clearly understand this "shift in the onus". Do not make the (general) mistake of thinking that only dispositions made within two years prior to sequestration can be set aside – there is no time limit in this regard.

- (4) The position will depend on the solvency of C's estate at the time when he (C) bound himself as surety. If C's assets exceeded his liabilities by at least R10 000 immediately prior to the conclusion of the suretyship contract, Bank B may prove a concurrent claim against C's insolvent estate for the entire surety debt. But if C was already insolvent at that time, Bank B will not have any claim to prove against the insolvent estate. However, if C's assets exceeded his liabilities, but by an amount less than R10 000, for example R4 000, Bank B will be able to prove a claim for only part of the debt, for example R4 000. It is therefore in the bank's best interest always to ensure that the surety's assets exceed his liabilities by at least the amount of the principal debt.
- (5) This statement is false. Section 26 of the Insolvency Act does not require the trustee to prove that the insolvent intended to prefer one of his or her creditors above another.

You will learn about the principle of the insolvent's intention to prefer a creditor above another creditor when you reach study unit 15. At this stage, it is sufficient for you to note that self-test question 5 reveals an important difference between section 26(1)

concerning dispositions made without value and section 30(1) concerning undue preferences. To read sections 26(1) and 30(1), consult the Insolvency Act at the back of Hockly. Under section 30(1) on undue preferences, the trustee is required to prove, among other things, that the insolvent made a disposition to a creditor (ie, a person to whom the insolvent was already indebted before he or she made the disposition). Under section 30(1), the trustee must also prove that the insolvent intended to prefer that creditor above the other creditors.

There is another feature of section 26(1) that you should also notice. Section 26(1) does not require that the disposition must have been made to a creditor of the insolvent. Consequently, provided that the other requirements of section 26(1) are met, the section may apply even if the person benefited by the disposition was not a creditor of the insolvent.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 15

VOIDABLE DISPOSITIONS – VOIDABLE AND UNDUE PREFERENCE, COLLUSIVE DEALINGS AND THE *ACTIO PAULIANA*

In study unit 14, you studied the first remedy concerning impeachable dispositions: the disposition without value. Now, in study unit 15, you will learn about four further remedies concerning impeachable dispositions. The first three of these remedies are statutory provisions under the Insolvency Act. The fourth is a common-law remedy for attacking dispositions. All four of these further remedies may therefore be utilised by the trustee who is seeking to attack the dispositions that Tenza made before his estate was sequestrated.

After completing this study unit you should be able to

- explain the requirements for setting aside a disposition as a voidable preference, and the defence against this challenge to such a disposition
- explain the requirements for setting aside a disposition as an undue preference
- describe the differences between the application of section 29 (voidable preference) and section 30 (undue preference) of the Insolvency Act
- discuss the requirements for, and the consequences of, the setting aside of a disposition as a collusive dealing
- explain the requirements for the *actio Pauliana*
- identify the dispositions which could possibly be set aside in a given set of facts, and apply the correct principles to that set of facts
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit.

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly chapter 12 from 12.2.2 up to and including 12.2.5.

Also study the following:

***Estate Wege v Strauss* 1932 AD 76 (case [36] in Loubser)**

***Pretorius' Trustee v Van Blommenstein* 1949 (1) SA 267 (O) (case [37] in Loubser)**

***Hendriks NO v Swanepoel* 1962 (4) SA 338 (A) (case [38] in Loubser)**

***Pretorius NO v Stock Owners' Co-operative Co Ltd* 1959 (4) SA 462 (A) (case [39] in Loubser)**

12.2.2 Disposition which prefers one creditor above another: voidable preference

Take special note of all the elements which a trustee must prove before he may set aside a disposition as a voidable preference in terms of section 29 of the Insolvency Act. Also note that **the defence available to the creditor consists of two elements**. To avoid the setting aside of the voidable preference, after the trustee has proved all that he must prove, the creditor must prove that the disposition took place in the ordinary course of business **AND** that the debtor (insolvent) did not intend to prefer him above other creditors. Do not make the mistake of saying that section 29 itself provides for two defences.

Study the following three **prescribed** cases on section 29:

- (1) *Estate Wege v Strauss* 1932 AD 76 (the last part of the decision deals with s 29)
- (2) *Pretorius' Trustee v Van Blommenstein* 1949 (1) SA 267 (O)
- (3) *Hendriks NO v Swanepoel* 1962 (4) SA 338 (A)

Of these cases, *Wege* makes it clear that the practices which exist in a particular business sphere are important for deciding whether a particular disposition took place in the ordinary course of business. Sometimes it is extremely difficult to establish whether a particular disposition took place in the ordinary course of business. *Hendriks* shows this: two judges concluded that the transaction was not unusual (ie, it was in the ordinary course of business), but the other three judges concluded that the transaction was unusual (ie, it was not in the ordinary course of business). Note how the judges differed on the following two questions:

- (1) whether, over a short period, the sheep would regain their original value, and therefore
- (2) whether, on the face of it, the transaction was extremely prejudicial for Swanepoel.

Obviously, if the insolvent did not foresee the possibility of his estate being sequestrated he could not have had the intention to prefer. Proof that the insolvent entertained the idea that he would escape his financial quandary is not **by itself** sufficient evidence to prove the absence of the intention to prefer, as *Van Blommenstein* shows. Even if the insolvent hoped that he would overcome his financial problems he could still have foreseen sequestration as substantially inevitable. But if it appears (as in *Van Blommenstein*) that, objectively viewed, there are reasonably good prospects that the insolvent would overcome his problems it can be accepted that he did not contemplate sequestration when making the disposition.

Activity 1

Answering the following questions in this activity will help you understand the principles concerning the term “in the ordinary course of business”, as discussed in Hockly 12.2.2(ii) and the prescribed cases. Your answers to the following questions should not exceed two sentences.

- (1) What is the importance of the phrase “in the ordinary course of business” in the context of section 29 of the Insolvency Act?
- (2) What **test** do the courts apply to establish whether the transaction took place in the ordinary course of business?
- (3) What **factual** circumstances could possibly play a role?
- (4) What is the position when a **specific type of business** is involved?

Feedback

- (1) Here you should have explained that one of the two elements in the defence against section 29 is that the disposition took place in the ordinary course of business. (The other element is the absence of the intention to prefer.)
- (2) The answer “an objective test” is important, but not sufficient: you must also describe the test, namely that the court, **in considering the transaction and the surrounding circumstances, looks at whether the transaction is one which two solvent business persons would conclude**. A good answer should also mention that the court looks at the two elements of the defence separately. When applying the “ordinary-course-of-business” test, the court thus ignores factors which reflect on the intention to prefer. (Do you think that the court succeeded in separating the “intention-to-prefer” factors from the “ordinary-course-of-business” test in *Van Blommenstein*?)
- (3) Here you should have referred to specific factual circumstances which, although not decisive, would be a good indication of whether the transaction took place in the ordinary course of business. The fact that the contract was exceptionally disadvantageous to one party, for example, played an important part in *Hendriks*. The fact that security was lodged for a debt which previously existed is also, generally, not in the ordinary course of business. If you have to answer a problem question about this, note similar indications in the given facts.
- (4) It is a factual question whether a specific type of business with its own distinctive practices exists. If such a fact is proved, the court, when evaluating the transaction, will take into account those practices existing in that business.

12.2.3 Disposition intended to prefer one creditor: undue preference

When studying the **prescribed** decision in *Pretorius NO v Stock Owners' Co-operative Co Ltd* 1959 (4) SA 462 (A), you will note that the trustee is seldom able to prove **directly** that the insolvent, when making the disposition, realised that sequestration was substantially

inevitable. One would usually have to infer this fact, whether it was the case or not, from the surrounding circumstances. (When you infer a fact, you reach a conclusion by reasoning from the evidence.) In *Pretorius NO v Stock Owners' Co-operative Co Ltd*, the insolvent debtor, Froneman, was dead by the time that the trial began, and so he could not be called to give evidence on whether he had contemplated sequestration and intended to prefer Stock Owners' Co-operative Co Ltd. The appeal court concentrated on the following circumstances when it drew the inference that Froneman had indeed contemplated the sequestration of his estate (see the judgment at p 472): Froneman was a speculator in cattle, but his chief asset was credit granted to him by his creditors. At the relevant time of the disposition of the cattle that credit was growing thin. Jones, the manager of Stock Owners' Co-operative Co Ltd, was pressing Froneman to pay off his debt to the company. Nor did the Bank seem likely to help Froneman. Froneman's creditors, who had been put off by promises of payment, were now expecting Froneman to pay them. By making the disposition of 193 head of cattle to Jones, Froneman deprived himself of almost all his stock in trade, and he lacked the means to continue his speculating business. Between the date of that disposition (4 Oct) and the date of his death (15 Oct) Froneman did not seem to try to continue his speculating business. Instead, he merely made promises which he knew that he could not perform. As an experienced businessman Froneman realised both his financial position and his inability to meet the promises by which he had held off his creditors. He also must have known that once the other creditors learned about his disposition of the cattle to Jones, as they inevitably would, they would demand to be paid. So Ramsbottom JA concluded that, at the date of the disposition of the cattle to Jones on 4 October, Froneman must have known, and did know, that the sequestration of his estate would soon be inevitable.

Activity 2

The existence of **an intention to prefer plays an important part** in both **voidable preferences** and **undue preferences**. This activity will help you understand the significance of this intention to prefer. Answer the following questions about it:

- (1) State which part the intention to prefer plays in voidable preferences and undue preferences respectively.
- (2) Explain why the insolvent's realisation that the sequestration of his estate is substantially inevitable is so important for a finding that he or she had the intention to prefer.
- (3) List all the factual circumstances which were mentioned in *Pretorius' Trustee v Van Blommenstein* and *Pretorius NO v Stock Owners' Co-operative Co Ltd* above, and which indicate the existence or absence of an intention to prefer. It would be a good idea to divide your list, in order to separate those facts indicating the **existence** of such an intention from those indicating the **absence** of the intention to prefer.

Feedback

- (1) You must explain that in the case of a voidable preference (s 29), the beneficiary may avoid its setting aside if, as a **defence**, he or she can prove that the insolvent did not have the intention to prefer him or her above other creditors, and also that the disposition was made in the ordinary course of business. The **absence** of an

intention to prefer is thus part of the defence, and the onus rests on the creditor who benefited from the disposition.

The trustee may set aside a disposition as an undue preference (s 30) only if he or she can prove the existence of an intention to prefer. The trustee bears the onus in this instance.

- (2) If the insolvent believed that his or her estate was solvent or that it would again become solvent shortly, then, by implication, he or she believed that all the creditors would receive full payment. When the insolvent accordingly pays one creditor, there is no question of an intention to prefer. But once the insolvent foresees that sequestration is substantially inevitable he or she would then also realise that there are most probably insufficient assets in the estate to pay all the creditors. If the insolvent then made a payment to one of the creditors he or she would most likely have intended to prefer that creditor above the others, who would receive only part payment, after sequestration. The realisation that sequestration is inevitable is thus important, because it “opens the door” for the intention to prefer. But remember that another motive for the disposition could exist.
- (3) The answer should be clear when you study the cases well. Remember to look for similar circumstances in problem questions on this topic. Make sure that your list refers to factual circumstances. The following examples should put you on the right track.

<i>indicates intention to prefer</i>	<i>indicates absence of intention to prefer</i>
relationship or affinity	pressure by creditor

12.2.4 Collusive disposition which prejudices creditors or prefers one creditor

There are two distinguishing features between undue preferences and collusive dispositions, namely.

- (1) Not only the insolvent, but also the other party which took part in the collusion, had the intention to prefer or to prejudice the group of creditors. There must be an element of collusion between the insolvent and the other party.
- (2) The collusion does not necessarily have to take place between the insolvent and a creditor of the estate. The insolvent and his brother (who is not a creditor of the insolvent) could, for example, agree that an estate asset should be alienated to that brother in order to put it out of reach of the creditors.

When one deals with collusion between the insolvent and one of the creditors, one would usually also be dealing with an undue preference in terms of section 30 of the Insolvency Act. The trustee would then have a choice of relying on either section 30 or section 31 of the Insolvency Act. If the trustee has this choice he would usually rely on section 31, because section 31 grants the trustee **three wider legal remedies** than section 30 does:

- (1) In addition to setting aside the disposition the trustee relying on section 31 may recover any **damage** caused by the disposition. But once the disposition has been set aside there will usually be no remaining damage.
- (2) The trustee may recover a **penalty** provided for by section 31(2) from the person who was party to the collusive disposition.
- (3) When the person who is party to the collusion is a creditor of the insolvent the **creditor loses any claim** he could have proved against the estate. The court has a discretion regarding the amount of the penalty which the trustee may recover, but the forfeiture by a collusive creditor takes place automatically (see *Gert de Jager (Edms) Bpk v Jones NO en McHardy NO* 1964 (3) SA 325 (A) 337).

Activity 3

Consider the following example of the application of section 31 of the Insolvency Act. Tenza owes his friend Beth R10 000. While Tenza's liabilities exceed his assets and sequestration is inevitable Beth approaches Tenza for payment. Tenza informs Beth of his position and that he has no more cash with which to pay. They agree that Beth will take two of Tenza's paintings valued at R10 000 in lieu of payment for the debt, so that Beth will not suffer any loss in view of the approaching sequestration of Tenza's estate. Explain the implications of the trustee's success in having this transaction between Tenza and Beth set aside as a collusive dealing under section 31.

Feedback

After the sequestration of Tenza's estate the trustee may recover the paintings (or their value, namely R10 000 – see s 32(3)) from Beth for the benefit of Tenza's insolvent estate. The trustee may also recover a penalty not exceeding R10 000 from Beth. Beth will also be unable to prove her claim of R10 000 owing to her against Tenza's insolvent estate, even if she has returned the paintings (or their value) to the trustee and paid the penalty.

12.2.5 Disposition in fraud of creditors (*actio Pauliana*)

Remember that the *actio Pauliana* is the **common-law** remedy, but that the other remedies which we have discussed above are the **statutory** remedies under the Insolvency Act. Those statutory remedies have therefore not excluded the *actio Pauliana*, which remains a remedy if its requirements are met.

Note that the circumstances in which the *actio Pauliana* is available overlap to a great extent with the circumstances in which section 26 or section 31 of the Insolvency Act is available. If section 31 of the Insolvency Act is available the trustee would rely on that section rather than on the *actio Pauliana*, because section 31 provides wider legal remedies for the trustee.

Activity 4

It is sometimes difficult to distinguish among the "application areas" of the different types of impeachable disposition. This activity requires the compiling of a table which you could find useful to remember the differences among the different types of impeachable disposition. The table also includes the disposition without value mentioned above in study unit 14. You

are, of course, welcome to use your own format, but the following table may be used as a guide. You merely need to fill it in.

	s 26	s 29	s 30	s 31	actio Pauliana
to whom					
when					
special characteristic(s)					
defence					
comment on onus					

Feedback

Remember that it is possible that more than one of the provisions could apply to a specific disposition. It could happen, for example, that a preference could be set aside under sections 29 and 30 of the Insolvency Act. In such a case, the trustee would rely on section 29, because it is easier to prove its requirements. But if the trustee can prove the requirements of sections 29, 30 and 31, he will set the disposition aside in terms of section 31, because he may also recover a penalty and the creditor forfeits any claims against the estate. If you have to choose, go for the “most effective with the least effort”. Refer to the other possibilities, but do not elaborate too much on them.

Your answer to this activity (which appears in the completed table below) may perhaps look like this:

	s 26	s 29	s 30	s 31	actio Pauliana
to whom	<i>any person</i>	<i>a creditor</i>	<i>a creditor</i>	<i>any person</i>	<i>any person</i>
when	<i>any time before sequestration (but see the difference of onus)</i>	<i>within six months before sequestration of the estate</i>	<i>at any time before sequestration of the estate</i>	<i>at any time before sequestration of the estate</i>	<i>at any time, even the debtor's estate has not yet been sequestrated</i>
special characteristic(s)	<i>(1) proof of inadequate counter-value (2) no proof of intention to prefer is required</i>	<i>(1) concentrates on effect of preference to creditor (2) time limit of six months</i>	<i>concentrates on intention to prefer a creditor</i>	<i>(1) collusion between debtor and recipient (2) further punishments and penalties</i>	<i>can be utilised by creditors even before debtor has been declared insolvent</i>

defence	<i>no defence once trustee proves requirements</i>	<i>One defence with 2 elements: transfer in the ordinary course of business AND no intention to prefer creditor above another</i>	<i>no defence once trustee proves requirements</i>	<i>no defence once trustee proves requirements</i>	<i>no defence once trustee proves requirements</i>
comment on onus	<i>Time-bound onus: (1) trustee to prove liabilities exceed assets if disposition more than 2 years before sequestration; (2) recipient to prove assets exceeded liabilities if disposition less than 2 years before sequestration;</i>	<i>Trustee bears onus to prove elements of the voidable preference (see Hockly 12.2.2(i)). After that, creditor (not the insolvent) must prove both elements of the defence to section 29 (see Hockly 12.2.2(ii)).</i>	<i>Trustee to prove requirements of undue preference.</i>	<i>Trustee to prove requirements of collusive dealing.</i>	<i>Plaintiff to prove requirements of actio Pauliana.</i>

We suggest that you test yourself regularly by seeing whether you can draw up and complete the above table of comparisons without looking at Hockly, this Study Guide, or your notes. By testing yourself often in this way, you will appreciate the similarities and differences between the various kinds of impeachable dispositions. This activity, like the others in this Study Guide, may well be an examination question.

SELF-TEST QUESTIONS

- (1) D is a pharmacist and has an account with a wholesaler E, where he purchases most of the chemist supplies. Since January, he no longer pays the full outstanding balance on his account at the end of the month as he did previously. In February, he even borrows R1 500 from his brother F to make a payment to E. On 14 April, E threatens to close D's account and to take judgment against him for the outstanding amount. D begs E to give him an extension and mentions that he will pay the amount once he has sold his motorboat. E grants D the extension on condition that he pledges the motorboat to him (E). D agrees and hands the motorboat to E the following day. On 20 May, D wins R3 000 in a competition and immediately pays an amount of R3 000 on his account to E. E keeps the motorboat as security for the remaining R3 400. D also pays back the R1 500 to F. On 10 June, D's estate is sequestrated.

Explain whether each of the following dispositions may be set aside:

- (a) the pledging of the motorboat to E
- (b) the payment of the R3 000 to E
- (c) the payment of the R1 500 to F

(20)

- (2) What difference would it make to your answers in 1 above if D's estate was sequestrated only on 20 December? (10)
- (3) Tenza owes his sister Bette R10 000 which he borrowed from her. Tenza realises that he is insolvent and cannot repay Bette. Tenza gives Bette an antique chair valued at R6 000 as a "gift". Bette is suspicious about this sudden large gift and refuses to accept it. Eventually, Tenza tells Bette why he made this decision. Bette accepts the chair because she wishes it to remain in the family. Tenza's estate is sequestrated two months later. Explain to Bette what her legal position is in this case. (6)
- (4) What are the requirements for the application of the *actio Pauliana* to a disposition if value has been received? (4)
- (5) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

If the trustee wishes to set aside a voidable preference under section 29 of the Insolvency Act he or she must prove that the insolvent intended to prefer one of his or her creditors above another.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) (a) The pledge of the motorboat is a disposition, because it entails the transfer of rights to E. The disposition took place within two months prior to sequestration and was made to a creditor of D's. The disposition could thus be set aside as a voidable preference because it falls within the required period of six months as set by section 29 of the Insolvency Act. The trustee will have to prove that the disposition had the effect of preferring E above other creditors. If there are insufficient assets in the estate to pay all the creditors, which most likely is the case, the effect of the pledge was to prefer E, because he thereby received security for his claim. The trustee must also prove that immediately after the pledge, D's liabilities exceeded his assets. In the light of the short lapse of time between the disposition and the sequestration it appears that this requirement would most likely be proved.

But E could avoid the setting aside if he could prove that the pledge was made in the ordinary course of business and that D did not have the intention of preferring him above the other creditors. E must prove both these elements. Although it is usually not in the ordinary course of business to lodge security for an existing debt it could possibly be regarded as normal if the security were lodged in order to obtain a postponement for payment of the debt. In *Pretorius' Trustee v Van Blommenstein*, the court found in similar circumstances that the pledge had taken place in the ordinary course of business. As far as the second part of the defence is concerned, E will have to prove that D did not make the disposition with the intention of preferring him, but for another reason. E will be

able to prove that D made the disposition to receive extension for the payment of his debt and to avoid having his account closed. The fact that E exerted pressure on D is an important indication of the absence of intention to prefer: this factor was also taken into account in *Van Blommenstein*. E should therefore be successful with his defence.

- (b) Payment of the R3 000 to E is a disposition made to a creditor within six months prior to sequestration. It could therefore possibly be set aside as a voidable preference in terms of section 29 of the Insolvency Act if, immediately after the payment, D's estate were insolvent and if it had the effect of preferring E above other creditors. The problem lies with this last requirement. E already enjoyed security for his claim in the form of the pledge. Because E would probably in any event have received full payment of his claim at sequestration (remember that the pledge cannot be set aside) this payment of R3 000 has therefore not put him in a better position than he would have been in after sequestration. The payment can therefore not be set aside as a voidable preference.
 - (c) The repayment of the R1 500 to F is a disposition made to a creditor within six months prior to the sequestration. It had the effect of preferring F above the other creditors. If the trustee could prove that D's liabilities exceeded his assets immediately after the disposition, the disposition could be set aside as a voidable preference in terms of section 29. Because the payment was made less than a month prior to sequestration the trustee should be able to prove this element. F could avoid its setting aside only if he could prove that the payment was made in the ordinary course of business and that D did not have the intention of preferring him above other creditors. Because F and D are brothers and because D, just prior to sequestration, probably realised that sequestration was inevitable, it must be accepted that D had the intention to prefer F. F will therefore not succeed in preventing the disposition from being set aside.
- (2)
- (a) The trustee could not rely on section 29 of the Insolvency Act, because the pledge took place more than six months prior to sequestration. He would have to try to set it aside as an undue preference. He would then have to prove that D's liabilities exceeded his assets at the time of the disposition and that D had the intention to prefer E. To prove this intention he would have to prove, first, that D foresaw that sequestration was substantially inevitable (*Pretorius NO v Stock Owners' Co-operative*) and, second, that there was no other good explanation for the disposition. Because the disposition took place eight months prior to sequestration it will be difficult to prove that D foresaw the possibility of sequestration. Also, there is a good reason that D made the disposition: E exerted pressure on D, who complied with his wishes.
 - (b) Although the result will be the same in this case, the trustee could rely only on section 30. But he will not succeed, because E was not benefited above the other creditors and there was no intention to prefer him to others.
 - (c) Because the payment was made more than six months prior to sequestration the trustee will not be able to rely on section 29, but will have to rely on section

30. To have a payment set aside as an undue preference he will have to prove that D's liabilities exceeded his assets at the time of the payment, and that D had the intention to prefer F. It may be difficult to prove that his liabilities exceeded his assets in view of the length of time which had lapsed between payment and sequestration. To prove the intention to prefer, the trustee will have to present surrounding circumstances which justify the inference that D probably foresaw that sequestration was substantially inevitable (*Pretorius NO v Stock Owners' Co-operative*). If this inference can be proved, it will be accepted that D did indeed have the intention to prefer, unless there is another explanation for the payment. In this instance, there is no other explanation for the payment – quite the opposite: F is D's brother, and this relationship could indicate the intention to prefer. The outcome will depend on whether the trustee can prove that D foresaw sequestration when paying his brother.

- (3) The disposition of the chair to Bette can be set aside as a collusive dealing in terms of section 31. Tenza and Bette both knew that Tenza was insolvent and that the disposition would prejudice the creditors. Bette will therefore have to return the chair or its value. She will also be liable for any loss which resulted from the disposition. In this case, there does not appear to be any loss. A penalty of up to R6 000 could also be imposed upon Bette. Further, Bette loses her claim against the insolvent estate. She will therefore not receive repayment of her loan.
- (4) If the disposition is made for countervalue, the requirements for the *actio Pauliana* are stricter than those for a disposition without value. It must be proved that the insolvent had the intention to defraud the creditors and that the party who benefited from the transaction knew of this intention and was a party to the fraud.
- (5) This statement is false. The trustee seeking to set aside a voidable preference under section 29 does not have to prove that the insolvent intended to prefer one of his or her creditors above another. Instead, it is the **defendant creditor** who must prove that the insolvent did not intend to prefer one of the insolvent's creditors above another.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 16

IMPEACHABLE DISPOSITIONS – TRANSFER OF BUSINESS WITHOUT PRESCRIBED NOTICE

In the first self-test question for this study unit, you will read about a small shop and business that Tenza used to own. Tenza sold the shop and business shortly before his estate was sequestrated. But he did not advertise this intended sale before he entered into it. This failure to advertise the sale has certain implications in terms of section 34(1) of the Insolvency Act.

Note that section 34(1) concerns a “business” and its “goodwill”. “Goodwill” is

an intangible asset pertaining to an established and profitable business, for which a purchaser of the business may be expected to pay, because it is an asset which generates, or helps to generate, turnover and, consequently, profits.

See *Jacobs v Minister of Agriculture* 1972 (4) SA 608 (W) at 621.

After completing this study unit you should be able to

- set out the prerequisites to be complied with in order to ensure that the transfer of a business will definitely be valid
- indicate in what circumstances the transfer of a business will be void
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly 12.5 to 12.7.

Omit Hockly 12.3 to 12.4.3.

Also study the following:

***Ensor NO v Rensco Motors (Pty) Ltd* 1981 (1) SA 815 (A) (case [40] in Loubser)**

12.6 Transfer of business without prescribed notice

Note the following in connection with section 34(1) of the Insolvency Act:

- (1) It is the **transfer** of the business (not the contract of sale in terms of which the transfer takes place) that has to be advertised within the prescribed period. Accordingly, if Tenza sells his business to Bobby, the contract of sale should provide for a sufficient lapse of time from the date of the conclusion of the contract until the transfer takes place, so that the transfer may be advertised at least 30 days, and not more than 60 days, before the transfer.
- (2) If Tenza uses assets of his business as security for debts (eg, he cedes all his book debts to Bobby as security for the repayment of a loan) this step is obviously not a transfer in the ordinary course of that business. But advertisement need not take place, and the transfer is also not void, if Tenza's estate is sequestrated within six months after that, because the transfer has taken place as **security for a debt**.
- (3) If the transfer should have been advertised, but has not been advertised as required, the transfer is simply **void** if the estate of the trader concerned is sequestrated within six months after the transfer. Accordingly, the trustee need not first set the transfer aside before he or she reclaims the property. If the trustee reclaims the property the contract in terms of which the transfer took place also lapses. But as Hockly indicates, if it is in the interest of the insolvent estate to do so, the trustee may confirm the contract, and the transfer in terms of it.

Activity 1

This activity will help you understand the effect of section 34(1) of the Insolvency Act.

The fact that the transfer of a business has not been advertised in terms of section 34(1) does not necessarily mean that the transfer is void. Discuss this statement.

Feedback

This statement is correct. The transfer will not be void if the estate of the trader is not sequestrated within six months after the transfer.

Note that the decision in *Gore NO v McCarthy Ltd* 2006 (3) SA 229 (C) summarised in Hockly 12.6 second bulleted item has since been overruled on appeal in *McCarthy Ltd v Gore NO* 2007 (6) SA 366 (SCA). The appeal court held that a "trader" in terms of section 2 of the Insolvency Act carries on a trade, business, industry or undertaking as specified in the categories mentioned in that section. The question of whether a person is a trader is decided by reference to the nature of the undertaking (in *McCarthy Ltd v Gore NO*, the sale of vehicles) and then determining whether that forms part of the core business (in *McCarthy Ltd v Gore NO*, transport haulage) or is incidental to it. There are no degrees of incidentality. It was held that the sale of the vehicles in *McCarthy Ltd v Gore NO* was incidental to the core business of the relevant seller. The seller, not being a "trader" in terms of section 2, therefore did not need to comply with section 34(1) of the Insolvency Act in selling the vehicles.

12.7 Transfer of business after proceedings instituted

When you study the provisions of section 34(3) of the Insolvency Act it is helpful to remember the purpose of this subsection. This purpose has been described as follows (*Simon v DCU Holdings (Pty) Ltd and others* 2000 (3) SA 202 (T) at 223):

[W]here a business creditor has instituted his claim against a trader before the latter [ie, the trader] transferred his business, it makes sense that the transfer is void only as against that creditor in order to enable him to recover his claim in spite of the fact that transfer has already taken place. The subsection [ie section 34(3)] only applies to a business creditor because only business creditors of the trader are affected by the transfer of the business.

It is also important to remember that section 34(3) of the Insolvency Act may apply even if the trader concerned has advertised the intended transfer of the business as required by section 34(1) of the Act. So the creditor in question will still be protected by section 34(3) even though the trader has complied with section 34(1).

SELF-TEST QUESTIONS

- (1) Tenza owns a shop which sells furniture and electrical appliances. Because the business is not doing very well, especially as far as the sale of furniture is concerned, Tenza decides to sell only electrical appliances in future. On 2 June he concludes a contract with furniture dealer Helen, in terms of which Helen buys all the furniture which Tenza has in stock. The furniture is delivered to Helen on 20 June. But reducing the business still does not have the desired effect, and on 10 December Tenza's estate is sequestrated. Advise the trustee of Tenza's estate on the possibility of recovering the furniture.

(9)

- (2) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

If the business owns a lorry which the trader intends to pledge to the bank as security for a loan by the bank to the business, then the trader does not need to advertise this intended transfer of the lorry under section 34(1) of the Insolvency Act.

(2)

ANSWERS TO SELF-TEST QUESTIONS

- (1) Section 34(1) of the Insolvency Act applies to this situation. Tenza's stock of furniture clearly was part of the assets of his business. The transfer of the furniture did not take place in the ordinary course of Tenza's business. On the contrary, it was part of Tenza's attempt to change the nature of his business. Accordingly, to avoid the possible nullity of the transfer in case of sequestration, Tenza should have published a notice of the intended transfer in the *Government Gazette* and in two issues of an Afrikaans newspaper and two issues of an English newspaper circulating in the area of his business. This notice must appear not less than 30 days and not more than 60 days before the intended transfer. Because only 18 days elapsed here between the

conclusion of the contract and the delivery of the furniture, this requirement was clearly not met. Because Tenza's estate was sequestrated within six months after the delivery of the furniture, the transfer is void as against the creditors and the trustee. It follows that the trustee may recover the furniture from Helen.

- (2) This statement is true. This set of facts deals with one of the exceptions stated in section 34(1) of the Insolvency Act. The trader does not need to advertise the transfer of goods or property forming part of the business where the transfer is for securing the payment of a debt. The pledge in question is for securing the payment of the debt owed by the business to the bank under the contract of loan. So the trader does not need to advertise this transfer under section 34(1) of the Insolvency Act. See the fifth bulleted paragraph in Hockly 12.6.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED DURING THIS SESSION?

Omit Hockly chapter 13 on interrogation of the insolvent and other witnesses.

Omit Hockly chapter 14 on the duties of the insolvent.

Omit Hockly chapter 15 on realisation of the estate assets.

Study unit 17

CREDITORS' CLAIMS AND THEIR RANKING – THE DIFFERENT TYPES OF CREDITORS

In this study unit, you will examine the different classes of creditors' claims which may be made against an insolvent estate such as Tenza's. The law protects some of these claims more effectively than others.

After completing this study unit you should be able to

- define the concepts “security”, “free residue”, and “special mortgage”
- distinguish among secured, preferent, and concurrent creditors
- explain in what circumstances a bond gives no preference
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit.

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly chapter 16 from the beginning, up to and including 16.2.5.

Also study the following:

Joint Liquidators of Glen Anil Development Corporation Ltd (in Liquidation) v Hill Samuel (SA) Ltd 1982 (1) SA 103 (A) (case [41] in Loubser)

In an insolvent estate, there are seldom enough assets to pay all the proved claims in full. Although it is sometimes said that the purpose of sequestration is to treat the creditors equally it is more correct to say that an equitable distribution is pursued. On grounds of policy, some claims are given a higher ranking than others, with the result that they have a better chance of being paid in full. These better rights that secured and preferent creditors enjoy arise sometimes by agreement, and sometimes by operation of law (automatically). In this study unit, we deal with the different types of claim against an insolvent estate, and the order of ranking in which they are paid.

16.1 Types of creditors

As you can see, there are three categories of creditors:

- (1) secured creditors
- (2) preferent creditors
- (3) concurrent creditors

As far as ranking is concerned, a secured creditor (eg, a mortgage bondholder) is in the strongest position, because his or her claim is paid first out of the proceeds of a certain asset which serves as security for that claim. If the proceeds of the asset concerned are large enough such a creditor will therefore be paid in full. If something then remains of the proceeds it is added to the free residue (s 83(12)). The free residue is then distributed in the order of ranking set out in sections 96 up to and including 103 of the Insolvency Act. The claims set out in sections 96 up to and including 102 are all preferent claims but not secured claims, because they take preference over the claims of concurrent creditors, who are the last in line.

Remember that although concurrent creditors rank equally, they do not necessarily receive the same amounts when the free residue of the estate is distributed. The dividend payable to concurrent creditors amounts to a certain **proportion** of cents in the rand. So if, for example, one concurrent creditor of Tenza's insolvent estate has a claim for R2 000 and another concurrent creditor has a claim for R4 000, and the dividend is 50 cents in the rand, the one concurrent creditor will receive R1 000 and the other concurrent creditor R2 000 as a proportion of their respective claims:

The arithmetic for the first concurrent creditor's claim is as follows:

$$R2\ 000 \times 50/100 = R1\ 000$$

The arithmetic for the second concurrent creditor's claim is as follows:

$$R4\ 000 \times 50/100 = R2\ 000$$

These two concurrent creditors do not receive the same amount by way of dividends, because their claims against the insolvent estate differ in their amounts (the first concurrent creditor's claim being for R2 000, and the second concurrent creditor's claim being for R4 000).

Section 2 of the Insolvency Act defines the word "preference" as "the right to payment of that claim out of the assets of the estate in preference to other claims". It follows that, strictly speaking, secured creditors are also preferent creditors (see Hockly 16.1.3), although the expression "preferent creditor" is normally used with reference to the creditors contemplated in sections 96 to 102 only. Those unsecured, preferent creditors admittedly have a preference among themselves and above concurrent creditors, but they are not secured creditors, because their claims are not paid out of the proceeds of a specific asset.

Note that the word "**security**" refers **exclusively to REAL security**, that is a specific asset serving as security for the claim. An example of **real security** is a right of retention (see Hockly 16.2.4). If a garage, for example, has serviced your car, it may keep your car until paid the bill for the service. The real security enjoyed by the creditor (the garage) for the payment of this debt is the right to keep possession of the car until the debt has been paid. If your estate is sequestrated before the debt has been paid, the garage has a secured claim against the insolvent estate for the bill for the service. A distinction is usually made between

real security and personal security. **Personal security** is suretyship (see the explanation of suretyship in study unit 14 above, in relation to Hockly 12.1): If the principal debtor does not pay, the creditor may claim payment from the surety. If the surety is financially strong enough to pay, the creditor will obtain payment. But if the surety is also unable to pay, the suretyship does not help the creditor much, because the creditor does not have preference on the proceeds of a specific asset. This creditor's security is merely personal, not real. Real security is security created by the law of property, and personal security is security created by the law of contract, and thus by the law of obligations.

Note at this stage that the same asset may sometimes serve as security for the claims of two or more creditors (see further Hockly 16.3.1(ii)). The most usual example of this possibility is mortgage bonds over immovable property. If two or more mortgage bonds are registered over the same piece of land the bondholders' preferences among themselves over the proceeds are determined by the dates of registration of the bonds. An earlier bond enjoys preference over a later bond, in accordance with the Latin maxim *qui prior in tempore, potior in iure* (which means: "What is prior in time has preference in law.").

Activity 1

This activity will help you understand an important choice that the secured creditor must make when deciding to prove a claim against the insolvent estate of the debtor.

Section 89(2) refers to the possibility that a secured creditor who proves his or her claim may elect to rely exclusively on the proceeds of his or her security. What factors should a creditor consider when he or she makes his or her election?

Feedback

The answer should become clear when you study Hockly 16.1.2 attentively. When the creditor decides to rely exclusively on the security he or she loses any part of his or her claim which cannot be paid out of the proceeds of the encumbered asset. But if he or she does not limit his or her claim to the proceeds of the encumbered asset there is a greater risk that he or she would have to pay a contribution to the costs of sequestration. (On liability for contribution, you may read Hockly 17.1.4 if you wish. But you do not need to study Hockly ch 17 for the assignments, or for the examination.) In practical terms, it means that the creditor will have to consider the value of the encumbered asset, and the costs and any other secured claims which are to be paid out of the proceeds of the asset before his or her claim. If he or she thinks that his or her claim will not be fully covered by his or her security he or she should weigh up, on the one hand, the dividend that he or she will possibly receive on the unsecured part of his or her claim, and, on the other hand, the risk that the free residue may be insufficient to cover the costs of sequestration. It is, of course, not always possible to form a good idea of the value of the estate and the possible claims.

16.2.1 Special mortgage

You should distinguish clearly between a notarial bond over specific **movable** property which was registered after 7 May 1993, and a **general** notarial bond over **movable** property. The former provides security, and the latter merely a (relatively weak) preference in terms of section 102 of the Insolvency Act. A **general** notarial bond over **movable** property is a bond

which binds all the mortgagor's **movable** property in general. It is not possible to register a general bond over all the mortgagor's **immovable** property (cf s 86 of the Insolvency Act).

Activity 2

This activity will help you understand the difference between a special notarial bond and a general notarial bond. This difference affects the order of preference in which the two kinds of bonds rank against the insolvent estate.

Indicate whether the following bonds are **special** notarial bonds or **general** notarial bonds:

- (1) A bond over six lorries owned by the debtor. The details in the relevant bond include the registration numbers, types of vehicle, colours, chassis numbers, and engine numbers.
- (2) A bond over all the movables owned by the debtor.

Feedback

Bond (1) is a special notarial bond. It relates to a particular set of six lorries, which are **movable** and which are described in considerable detail so that they cannot be confused with any other lorries (or indeed, any other movables) that the debtor may happen to own at the relevant time.

Bond (2) is a general notarial bond. No details of any particular item of movable property are supplied in the notarial bond itself. So this bond could apply to lorries, cars, computers, and whichever other items of movable property the debtor may happen to own at the relevant time.

A bond over **immovable** property must specify the particular piece of land over which the bond is registered.

In Hockly 16.2.1 you will find a discussion of section 88 of the Insolvency Act. In connection with section 88, you should note the following:

- (1) A "kustingsbrief" is a bond which is registered simultaneously with the transfer of the piece of land concerned, in order to secure either the outstanding purchase price of the land, or the repayment of a loan made to the buyer to enable him to pay the purchase price of the land. Consider the following example of a "kustingsbrief": A sells his farm to B. B pays half the purchase price against registration of transfer, and the rest of the purchase price is secured by a bond over the land which is registered in favour of A simultaneously with the transfer to B. This bond is a kustingsbrief, and section 88 does not apply to it.
- (2) Section 88 applies not only to special mortgages (see the definition of "special mortgage" in s 2 of the Insolvency Act), but also to general notarial bonds over movable property.

- (3) Section 88 will deprive a bondholder of his preference only if **all three requirements** set out in the section are present. If one of the three requirements is absent, the bond will not be affected by section 88.

Consider the following example: Tenza borrows R20 000 from Carol, and Carol pays the amount over to Tenza. The parties agreed that the repayment of the loan will be secured by a bond over Tenza's house. Six months later, the bond is lodged for registration with the Registrar of Deeds concerned. Eight months after this lodging, Tenza's estate is sequestrated. In this case, Carol will still be a secured creditor and will enjoy preference in terms of the bond. Although the debt was older than two months when the bond was lodged for registration, and although the debt was previously unsecured, Tenza's estate was not sequestrated within six months after the lodging of the bond. So Carol's (the bondholder's) position is not affected by section 88.

Note that the date of lodging of the bond is **earlier** than the date of registration. The **date of lodging** is the date on which the relevant documents are presented to the staff of the Deeds Office. The staff of that Office then have to take the necessary steps to register the bond. This process may take several days. Only once this process is completed is the bond registered. The date on which the process is finished is the date of registration of the bond.

We can illustrate this process in a series of steps, namely:

- (1) Tenza needs R400 000 for a house.
- (2) Tenza therefore borrows the R400 000 from Payback Bank.
- (3) Payback Bank secures Tenza's repayment of the R400 000 by taking a mortgage bond (see the definition in s 2 of the Insolvency Act) over Tenza's house.
- (4) Payback Bank's attorneys prepare and lodge a mortgage bond over Tenza's property: the attorneys hand the documents in to the staff at the Deeds Office.
- (5) The staff at the Deeds Office register the mortgage bond against the title deeds of Tenza's house (ie, the staff put a stamp on the title deeds for the public to see).
- (6) If Tenza fails to pay the bank its instalments of money under the contract of loan, Payback Bank can call up the bond, take judgment against Tenza, and sell the house.

In connection with section 88, you should note the **prescribed** judgment in *Joint Liquidators of Glen Anil Development Corporation Ltd (in Liquidation) v Hill Samuel (SA) Ltd* 1982 (1) SA 103 (A). The important point that was decided is that, for the purposes of section 88, a conditional debt becomes a debt only when the condition is fulfilled. Consider the following example with reference to *Glen Anil*: Tenza borrows R20 000 from Ben. Charlie binds himself as surety to Ben for the repayment of the loan by Tenza. Charlie's liability as surety is conditional, because he may be held liable only if Tenza fails to comply with his (Tenza's) repayment obligation. Six months after the conclusion of the loan agreement and the contract of suretyship, a bond in favour of Ben as security for Charlie's conditional obligation

as surety is lodged with the Registrar of Deeds, and registered. Four months after the lodging of the bond, Tenza defaults on the repayment of the loan. It appears that Charlie's estate was sequestrated a month after that (ie, five months after the lodging of the bond). Although Charlie's obligation as surety was not previously secured, and although his estate was sequestrated within six months after the lodging of the bond, his obligation as surety became unconditional only **after** the lodging and registration of the bond. According to the *Glen Anil* judgment, the debt, for the purposes of section 88, came into existence only at that stage. It follows that the secured debt was not older than two months when the bond was lodged for registration. In fact, the debt arose only after that. It follows that Ben will have a secured claim against Charlie's insolvent estate, and is not affected by section 88.

Note that, according to *Glen Anil*, a debt arises as soon as the debt is unconditional. It is not necessary that the debt should already be due.

There is an amusing way of remembering the operation of section 88 by means of an analogy or comparison with a board game. This comparison was once used by a lecturer to explain section 88 to a student who telephoned for an explanation 30 minutes before an examination in Insolvency Law, and that student (and several others since) found it helpful! Imagine that the two numerals 88 are made up of two snakes. Then think of the board game Snakes and Ladders. As you remember, players throw dice to advance along the squares on the board. The aim of the game is to be the first player to reach the top of the board. If a player throws the dice and finds that his or her counter lands on a square at the foot of a ladder, that player travels up the ladder to the square at the top of the ladder. But if a player throws the dice and then lands on a square occupied by the head of snake, that player goes down the length of the snake to the square occupied by the tail of the snake.

The comparison between section 88 of the Insolvency Act and the game of Snakes and Ladders is then that a creditor trying to aim for a higher position in the order of preference (either at the top as a secured creditor, or lower down as a statutory preferred, unsecured creditor) lands on the head of a long snake and goes all the way down to the lowest position in the order of preference, to the class of ordinary, concurrent creditors who enjoy no preference at all.

Activity 3

This activity will give you practice in classifying different types of claim against an insolvent estate.

- (1) Indicate which type of claim – secured, preferent, or concurrent – arises from each of the following types of bond:
 - (a) a special mortgage over immovable property
 - (b) a general bond over immovable property
 - (c) a special mortgage over specific movable property registered before 7 May 1993 somewhere other than in Natal
 - (d) a special mortgage over specific movable property registered before 7 May 1993 in Natal
 - (e) a special mortgage over specific movable property registered on or after 7 May 1993
 - (f) a general bond over movable property

Feedback

The answer should become clear from Hockly 16.2.1, read with section 86 and the definition of “special mortgage” in section 2 of the Insolvency Act. The bonds in (a), (d), and (e) grant secured claims, but those in (c) and (f) grant preferent claims. The bond mentioned in (b) grants no security or preference, unless it was registered before 1917 or falls under the proviso to section 86.

16.2.2 Landlord’s legal hypothec

You may find it helpful to know a little more about the landlord’s legal hypothec. (This hypothec was mentioned in the second bulleted item in the list in Hockly 7.2.3(ii).) This form of real security will be discussed in more detail in your courses on the law of property and on the law of lease. Basically, this hypothec (a word which originates from a Greek word for “deposit”) relates to the fruits and crops on the premises (the immovable property) let, and also to certain types of good (eg, a TV and a video machine or other furniture) that have been brought onto those premises. This hypothec arises automatically once the tenant fails to pay the rent that is due, and it continues to exist while the fruits and crops and relevant goods remain on the premises. To make sure that those fruits and crops and relevant goods may then be sold, the landlord should take the necessary steps by way of interdict or attachment order to identify these items. After these items have then been sold, the landlord recovers the amount of the debt owing from the proceeds of the sale (ie, the money for which the property was sold). Any remaining balance of the proceeds of the sale of the relevant goods must be paid to the tenant or, if the tenant’s estate has been sequestrated, to the trustee of the tenant’s insolvent estate.

16.2.3 Pledge

Note that a right of pledge is based on **possession** of the thing. Only when the thing has been delivered in pledge to the creditor does the right of pledge arise. The creditor must also retain possession of the thing. If he or she voluntarily relinquishes possession, his or her right of pledge lapses.

An example of a pledge would be the following: A needs to borrow money from B, and B lends A the money under a contract of loan. But B wishes to secure the repayment of the money by A, so B asks A for a pledge of movable property belonging to A. A hands over his watch (an item of **movable** property) to B. A is then the pledgor of the watch, and B is the pledgee of the watch. If the money is not repaid as agreed under the contract of loan B as the pledgee may take steps to have the watch (the pledge) sold. The pledgee (B) recovers the amount of the debt from the proceeds of this sale. Any remaining balance of the proceeds of the watch must be paid to the pledgor (A) or, where the pledgor’s estate has been sequestrated, to the trustee of the pledgor’s insolvent estate.

16.2.4 Right of retention

When someone has improved the property of another in terms of a contract, the person who has made the improvements has

- (1) a debtor-creditor lien for the agreed contract price, and

- (2) an enrichment right of retention for the amount by which the value of the property has increased

This result does not mean that the improver may claim both the contract price and the increase in value. The improver's claim is limited to the outstanding contract price. But with respect to that part of the contract price which overlaps with the increase in value, the improver has two types of right of retention as security, and he or she may choose which one he or she wishes to rely on. If the increase in value is greater than the contract price, the claim remains limited to the agreed contract price.

16.2.5 Instalment agreement hypothec

We suggest that you reread the discussion of section 84 of the Insolvency Act in Hockly 7.2.8.

SELF-TEST QUESTIONS

- (1) Define the following concepts for the purposes of the Insolvency Act:
- (a) "security" **as defined in section 2 of the Insolvency Act** (5)
- (b) "special mortgage" **as defined in section 2 of the Insolvency Act** (5)
- (2) Explain the difference between a secured claim and a preferent claim. (6)
- (3) B is the only member of A CC, a close corporation which carries on a transport and delivery business. On 5 June 2006, A CC obtained a loan of R20 000 from C Bank. As security for the loan, a notarial bond in favour of C Bank over one of A CC's delivery vehicles was lodged for registration on 11 August 2006, and registered on 4 September 2006. Also, on 5 June 2006, B bound himself as surety and co-principal debtor towards C Bank for the close corporation's debt. A CC's winding-up commenced on 20 February 2007 (winding-up has, for the purposes of s 88, the same effect as sequestration). C Bank then immediately sued B in his capacity as surety and co-principal debtor for payment of the outstanding amount on the loan. In return for an extension for payment, B agreed to have a general notarial bond over all his movable property registered in favour of C Bank. The bond was lodged on 10 April 2007, and was registered two weeks later. B's estate was sequestrated on 30 May 2007.
- Explain to C Bank what preference, if any, is afforded by the two bonds. Give specific attention to the possible application of section 88 to the bonds. (14)
- (4) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

A secured creditor is always a preferent creditor, but a preferent creditor may not necessarily be a secured creditor.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) (a) Your definition need not be literally the same as that in the Act, but your answer should indicate that the concept refers to property of the insolvent estate over which a creditor enjoys a preference by virtue of a special mortgage, landlord's legal hypothec, pledge, or right of retention. It is important that you mention all four of these forms of security.

In a question such as (1)(a), we do not expect you to discuss the various kinds of security (such as pledge) themselves, or to explain the concept of security itself. Instead, the question is focussed on the relevant definition in section 2 of the Insolvency Act. For this reason, we have stressed the words "as defined in section 2 of the Insolvency Act" in the question by placing them in bold text. You should also note that, for the purposes of question (1)(a), it would also be incorrect to discuss suretyship, which is a form of personal security, not a form of real security.

- (b) Your answer should set out the three types of special mortgage: (i) a bond which hypothecates immovable property, (ii) a notarial bond which hypothecates movable property which is specifically described in it, in terms of section 1 of the Security by Means of Movable Property Act, and (iii) a notarial bond over specific movable property registered before 7 May 1993 in terms of the Notarial Bonds (Natal) Act.

Note that question (1)(b) does not require you to describe the three kinds of special mortgage in detail, or to explain the concept of a mortgage itself. Instead, the question is focussed on the relevant definition in section 2 of the Insolvency Act. For this reason, we have stressed the words "as defined in section 2 of the Insolvency Act" in the question by putting them in bold text.

- (2) A secured claim is paid out of the proceeds of a specific encumbered asset. (If those proceeds are insufficient, the unpaid balance is paid as a concurrent claim from the free residue, unless the creditor has waived the unsecured balance of his claim.) A preferent claim is paid out of the free residue (the proceeds of the unencumbered assets), but enjoys preference over concurrent claims. (If only part of a claim enjoys preference, the balance is also treated as a concurrent claim.)
- (3) This question concerns the provisions of section 88 of the Insolvency Act, which states that the bond provides no preference in certain circumstances. The circumstances must **all** be present before the bond will be affected by section 88. The circumstances are as follows:
- (a) The bond must have been lodged for registration more than two months after the debt had been incurred.
- (b) The debt must not have been secured previously.
- (c) The estate of the mortgagor must have been sequestrated within six months after the lodging of the bond.

As far as the bond over the delivery vehicle of the close corporation is concerned it was lodged more than two months after the debt had been incurred, and the debt had not been secured previously. But A CC was wound up more than six months after the lodging of the bond, with the result that section 88 cannot apply. (Keep in mind that the **date of lodging** – not the date of registration – is taken into account here.) The bond meets the definition of “special mortgage”, and therefore provides C Bank with a secured claim.

The general bond over B’s movable property was registered with respect to his obligation as surety. Although B had already bound himself on 5 June 2006 – more than two months before the lodging of the bond – the debt arose only when A CC failed to pay, and C Bank claimed payment from B. In *Joint Liquidators of Glen Anil Development Corporation Ltd (in Liquidation) v Hill Samuel (SA) Ltd* the court decided that a deed of suretyship creates a conditional debt, and that the debt becomes a debt for the purposes of section 88 only when the condition is fulfilled, that is when the principal debtor defaults and the surety may be required to pay. Accordingly, the debt covered by the general bond came into existence only on 20 February 2007. The bond was lodged for registration within two months after that. The fact that B’s debt as surety had not been secured previously and that his estate was sequestrated within six months after the lodging of the bond cannot therefore cause the bond to be ineffective. All the circumstances mentioned in section 88 must be present before the section may be applied. Accordingly, this general bond provides C Bank with a preferent claim. (Note that it is not a secured claim.)

- (4) This statement is true. See the first paragraph in Hockly 16.1.3. The first part of the statement in question 4 is true, because it refers to the term “preferent creditor” in the wide sense, as any creditor who is entitled to receive payment before other creditors (cf the definition of “preference” in s 2 of the Insolvency Act). The second part of the sentence in question 4 is also true, because a “preferent creditor” in the narrow, more usual sense of the word is a creditor whose claim is not secured, but nevertheless ranks above the claims of concurrent creditors. Because both parts of the statement are true, the whole statement is true.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 18

CREDITORS' CLAIMS AND THEIR RANKING – THE ORDER OF RANKING FOR PAYMENT

In study unit 17, you studied the three different classes of creditors: secured, preferent, and concurrent. Now, in study unit 18, you will study the order of preference in which these classes of creditors must be paid when an insolvent estate such as Tenza's is distributed. It may be helpful to think of this order of preference as a queue, with the secured creditors first in the queue, the preferent creditors second in the queue, and the concurrent creditors last in the queue. Remember that the **secured creditors** are paid from the proceeds of **specific encumbered assets** in the insolvent estate. (An encumbered asset is an asset that is burdened in some way: eg, a plot of immovable property may be encumbered (burdened) by a mortgage bond; and an item of movable property such as a watch may be encumbered (burdened) by a pledge.) By contrast with the secured creditors, the **preferent and the concurrent creditors** are paid from the **free residue** (the unencumbered assets) of the insolvent estate.

After completing this study unit you should be able to

- set out and apply the principles on the application of the proceeds of encumbered assets
- set out and apply the principles on the application of the free residue
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly chapter 16 from 16.3 to the end of the chapter.

16.3.1 Encumbered assets

An encumbered asset is simply an asset that serves as real security. It is important to note that the secured creditor is not simply entitled to a preference with respect to the total proceeds of the asset. First, the costs mentioned in section 89(1) of the Insolvency Act are paid from the proceeds. After that, the claims of the secured creditors are paid.

As regards 16.3.1(ii), note that arrear interest on a secured claim for a period of only two years is also secured. If interest for a period longer than two years is in arrears, the claim for this interest is a mere concurrent claim.

Activity 1

This activity will help you focus on possession as a requirement of some forms of security, but not of others.

Which forms of real security require that the creditor must actually possess the encumbered asset?

Feedback

Possession is a prerequisite for the existence of two types of security: a right of retention (otherwise known as a lien), and a pledge. A special mortgage (a notarial bond) over **movable** property does not require possession, but the property is regarded as having been delivered in pledge to the mortgagee; in other words, the movable property is treated as having been delivered in pledge.

16.3.2 Unencumbered assets (free residue)

16.3.2(v) Salary or remuneration of employees

In connection with Hockly 16.3.2(v), reread Hockly 7.2.6(i) above on the suspension or termination of employment contracts when the **employer's** estate is sequestrated. If these employment contracts are suspended or terminated under section 38 of the Insolvency Act, the employees have preferent claims provided for in section 98A of the Insolvency Act. As regards these preferent claims, note the following:

- (1) The limit on the preferent claims for salary, wages, leave or other payments applies to **each employee separately**.
- (2) If an employee's claim for salary, wages, leave or other payments **exceeds** the limits of the preference, he or she has a **concurrent** claim for the excess under section 38(10) of the Insolvency Act as loss suffered because of the suspension or the termination of the contract before its expiry.

Consider the following example of the application of section 98A of the Insolvency Act: The insolvent had three employees – A, B and C. A earned R6 000 per month, B R4 000 per month, and C R2 000 per month. A and B have not received their salaries for the past three months, and C has not received his salary for the last month. Because only three months' arrear salary enjoys a preference, and because each one's preference is also limited to R12 000, the position is as follows: A will have a preferent claim for R12 000, B will have a preferent claim for R12 000, and C will have a preferent claim for R2 000. A will have to prove a concurrent claim for the rest of his salary, but B and C will be able to recover the full amounts of their arrear salaries as preferred, not concurrent, claims.

16.3.2(viii) Claim secured by general and special bond

When you study Hockly 16.3.2(viii), reread Hockly 16.2.1. Secured creditors include the notarial bondholder over specific movable property whose bond was registered after 7 May 1993, and the bondholder whose bond was registered in Natal before that date. All other

notarial bondholders over movable property are general notarial bondholders who enjoy a slight preference which ranks just before concurrent creditors. They are therefore paid from the free residue which remains after payment of the claims in terms of sections 96 to 101 of the Insolvency Act. The mutual ranking among general notarial bondholders in terms of section 102 of the Insolvency Act is determined by the dates of registration of the bonds. Consider the following example: After payment of the claims in terms of sections 96 to 101 there is R10 000 left in the free residue. A and B hold general notarial bonds over the movable property of the insolvent. A's bond was registered first, and the outstanding amount of his claim is R8 000. B's bond was registered second, and the outstanding amount of his claim is R4 000. A's claim will now be paid in full, B will get R2 000, and the concurrent creditors will get nothing.

16.3.2(ix) Claims of concurrent creditors

As explained in Hockly 16.3.2(ix), concurrent creditors stand last in line. They receive only a dividend on their claims, and sometimes even nothing. Consider the following example: After payment of the claims in terms of sections 96 to 102 of the Insolvency Act there is R10 000 left in the free residue. There are three concurrent creditors: A, B, and C. A's claim amounts to R20 000, B's claim to R25 000, and C's claim to R55 000. Accordingly, the total amount of the concurrent claims is R100 000, but there is only R10 000 to distribute. It follows that each concurrent creditor obtains a dividend of 10 cents in the rand ($R10\,000/R100\,000 = R0,10$). So A gets R2 000, B gets R2 500, and C gets R5 500.

Activity 2

Some of the preferences in terms of sections 96 to 102 of the Insolvency Act are subject to limitations on the amount of the claim which enjoys preference, or on the time when the claim must have arisen. These preferences are mentioned below. Fill in the limitation or qualification in the available space.

- (1) funeral expenses with respect to the insolvent himself
- (2) funeral expenses with respect to the insolvent's wife or his minor child
- (3) deathbed expenses with respect to the insolvent himself
- (4) deathbed expenses with respect to the insolvent's wife or his minor child
- (5) salary or wages of employees
- (6) leave payments to employees

Feedback

The answers to these questions are to be found in sections 96 and 98A of the Insolvency Act.

- (1) Funeral expenses with respect to the insolvent himself: if the insolvent died before the trustee's first account was submitted to the Master there is a preferent claim limited to a maximum of R300.
- (2) Funeral expenses with respect to the insolvent's wife or his minor child: if the expenses were incurred within the three months immediately preceding sequestration, there is a preferent claim limited to a maximum of R300.

- (3) Deathbed expenses with respect to the insolvent himself: if the insolvent died before the trustee’s first account was submitted to the Master there is a preferent claim limited to a maximum of R300.
- (4) Deathbed expenses with respect to the insolvent’s wife or his minor child: if the expenses were incurred within the three months immediately preceding sequestration there is a preferent claim limited to a maximum of R300.
- (5) Salary or wages of employees: if salary or wages are due to an employee, there is a preferent claim for a period not exceeding three months before sequestration, further limited to a maximum of R12 000.
- (6) Leave payments to employees: if any payment in respect of any period of leave or holiday due to an employee has accrued as a result of his or her being employed by the insolvent in the year of insolvency or the preceding year, whether or not payment is due at the date of sequestration, there is a preferent claim limited to a maximum of R4 000.

Activity 3

The purpose of this activity is to help you remember the order in which creditors’ claims rank in the order of preference.

Complete the following table showing the classes of claims in the proper order of preference:

The Ranking of Claims

Encumbered assets	
Initial costs	
(Any remaining balance) →→→→→→→→	Unencumbered assets (free residue)
	Funeral expenses

Feedback

Your completed table should look like this:

The Ranking of Claims

Encumbered assets	
Initial costs	
Secured claims	
(Any remaining balance) →→→→→→→→→→→→→→→→	Unencumbered assets (free residue)
	Funeral expenses
	Death-bed expenses
	Costs of sequestration
	Costs of execution
	Salary or remuneration of employees
	Certain statutory obligations
	Income tax
	Claim secured by general and special bond
	Claims of concurrent creditors

It is essential that the above claims appear in the correct order. This activity may well form the basis of an examination question.

Activity 4

The purpose of this activity is to help you understand the calculation of percentages of certain amounts of money. You will not be required to calculate percentages, either in the assignments or in the examination for this module.

In Hockly 16.3.2(ix) you read that the amount of interest on the concurrent claims must be calculated at the rate of 8% per annum. The word “percent” means: “Expressing a proportion: (by a specified amount) for, in, or to every hundred; by the hundred” (The *Oxford English Dictionary*, sv “percent”).

Suppose that the amount remaining in a certain insolvent estate after the payment of concurrent claims is R50 000. Interest at the rate of 8 percent per year (per annum) on this principal amount of R50 000 for one year is calculated as follows (see “Simple and Compound Interest”, accessible at <<http://www.getobjects.com/Components/Finance/TVM/iy.html>>:

$$\text{Simple Interest} = \frac{\text{Principal Sum} \times \text{Rate per cent} \times \text{Number of Periods}}{100}$$

$$\text{Simple Interest} = \frac{\text{R50 000} \times 8 \times 1}{100}$$

$$= \text{R4 000}$$

The total amount of interest on the capital sum of R50 000 at 8 percent per annum for one year is therefore R4 000.

SELF-TEST QUESTIONS

- (1) A bought a house, and caused a mortgage bond for R120 000 to be registered over it in favour of B Bank. Later, C fitted new wooden floors in the house at a contract price of R15 000. This improvement increased the value of the property by R10 000. Because A has not yet paid C, C holds a right of retention over the house, and A is prevented from moving into his house. A's estate is sequestrated, and the outstanding amount on the bond is R100 000.

Explain what amount B Bank and C will each receive if the proceeds of the property after deduction of the initial costs are R120 000, R112 000 and R100 000 respectively.

(12)

- (2) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

The employee has a preferent claim to any contributions which were, immediately prior to sequestration, owing by the insolvent in his capacity as employer (including contributions payable in respect of any of his employees) to any pension, provident, medical aid, sick pay, holiday, unemployment or training scheme or fund, or to any similar scheme or fund, to a maximum of R12 000 in respect of each scheme or fund.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) Note that your answer should explain the legal position. Merely mentioning the amount that each creditor will receive is not enough.

C has a claim of R15 000 against A's insolvent estate. R10 000 of C's claim is secured by an enrichment right of retention, because C has caused an increase of R10 000 in the value of the property. The full contract price of R15 000 is also secured by a debtor-and-creditor right of retention. B Bank's claim against A's insolvent estate amounts to R100 000, the outstanding amount on the bond loan. A claim secured by an enrichment right of retention enjoys preference over a mortgage bond over the same property, even if the bond was registered before the right of retention arose. Again, debtor-and-creditor rights of retention rank after mortgage bonds. For this reason, C should rely on the enrichment right of retention for the first R10 000 of the claim, and on the debtor-and-creditor right of retention for the remaining R5 000. The ranking order therefore is as follows: C: R10 000; B Bank: R100 000; C: R5 000.

Accordingly, if the available proceeds are R120 000, C and B Bank will each obtain full payment: so C will get R15 000 and B Bank R100 000. The remaining R5 000 will form part of the free residue. (Note that C may not claim R25 000 – C's claim is limited to the contract price.)

If only R112 000 is available, C will get R12 000 (R10 000 plus R2 000), and B Bank will get R100 000.

If only R100 000 is available, C will get R10 000 and B Bank R90 000.

- (2) This statement is false. To understand why the statement is false, look carefully at the wording of section 98A(1)(a) and section 98A(1)(b) on page 363 of Hockly. Notice that section 98A(1) begins as follows:

Thereafter any balance of the free residue shall be applied in paying– (a) to any employee who was employed by the insolvent –....

Then look further down to where paragraph (b) of section 98A(1)(b) begins:

(b) any contributions which were payable by the insolvent....

So, section 98A(1)(b) should be read in the following way:

Thereafter any balance of the free residue shall be applied in paying ... (b) any contributions which were payable by the insolvent....

The important point to understand is that those contributions were payable to “any pension, provident, medical aid, sick pay, holiday, unemployment or training scheme or fund, or to any similar scheme or fund”. Those contributions were not payable to “any employee who was employed by the insolvent”. So, when the employer’s estate is sequestrated, the preference in respect of those contributions payable to “any pension, provident, medical aid, sick pay, holiday, unemployment or training scheme or fund, or to any similar scheme or fund” is payable to such schemes or funds, not to the employees of the insolvent employer.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Omit Hockly chapter 17 on the estate accounts and the distribution of the estate.

Study unit 19

COMPOSITION

In this study unit, you will study a method by which Tenza, even if his estate has been provisionally sequestrated, may still be able to stop the sequestration process from running its full course. And even if Tenza is under s

equstration after the court has granted a final sequestration order against his estate, he may nevertheless be able to prevent the estate assets from being liquidated, and he may also be able to shorten the period of sequestration. To achieve these aims, however, Tenza would have to meet the strict requirements for entering into a **compromise** with his creditors under the **common law**; or else he would have to meet the easier requirements for entering into a **composition** with his creditors under **section 119 of the Insolvency Act**.

After completing this study unit you should be able to

- discuss common-law compromise
- discuss the offer, acceptance and consequences of a section-119 composition
- discuss the principles of the prescribed case of *Prinsloo en 'n ander v Van Zyl NO 1967 (1) SA 581 (T)*
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly chapter 18 from 18.4.5 to the end of the chapter.

Omit Hockly 18.5.

Also study the following:

Prinsloo en 'n ander v Van Zyl NO 1967 (1) SA 581 (T) (case [43] in Loubser

In a compromise, the concurrent creditors accept payment of an agreed dividend on their claims. It is usually also a condition of a compromise that some of the assets in the insolvent estate should be returned to the insolvent.

You will probably wonder why the creditors would accept such an offer. Many reasons may make such a compromise more advantageous than the normal course of the sequestration procedure. For example, a family member of the insolvent may be prepared to make an amount available for the execution of the compromise. And perhaps the dividends which the creditors would receive if all the assets were sold and their proceeds distributed in insolvency would be lower than if the insolvent's most important assets were returned to him or her and he or she could then earn an income and pay a dividend to the creditors.

Activity 1

This activity will help you make sure that you understand why concurrent creditors would consider entering into a compromise with an insolvent debtor.

State, in your own words, what you consider the advantage of compromise for the concurrent creditors. Explain why only concurrent creditors are involved in compromise.

Feedback

Remember that secured creditors are paid out of the proceeds of their security and that preferent creditors enjoy preference for the payment of their claims in terms of the provisions of the Insolvency Act. Usually, these creditors get paid out fully because of their order of preference. By contrast, concurrent creditors run the risk that no, or a minimal, amount will remain in the free residue after payment of the secured and the preferent creditors, and that concurrent creditors will therefore receive no, or a very small portion, of their claim at distribution. It is often to the concurrent creditors' advantage to accept the compromise. Note that although preferent creditors are not bound by the compromise (except in so far as they have done away with their preference), they, unlike the secured creditors, may vote with regard to their full claim, on the acceptance of the composition (see Hockly 18.4.1).

18.1 Common-law compromise

Activity 2

This activity will help you not to confuse a common-law compromise with a composition under section 119 of the Insolvency Act.

Distinguish between a common-law compromise and a section-119 composition.

Feedback

There are two basic differences between the two forms of composition. The first difference has to do with the legal basis of the two forms of composition: the one is based on the law of contract, but the other is statutory. The second difference concerns the requirement for acceptance: the one form of composition requires the written consent of **all** the concurrent creditors, but the other is based on a statutory mechanism by which the majority of creditors binds the minority.

18.2.2 Terms of composition

Activity 3

This activity will test whether you remember the rules that apply to some terms of a composition.

Summarise all the requirements which the terms of an offer for composition must meet in terms of section 119(7) of the Insolvency Act.

Feedback

The following three requirements are contained in section 119(7) of the Insolvency Act:

- (1) Where an offer of composition provides for the giving of security, the nature of the security should be specified fully and, if the security is to consist of a surety bond or guarantee, every surety should be named.
- (2) An offer of composition may not be accepted if it contains a condition entitling one creditor to obtain as against another creditor a benefit to which the former would not have been entitled upon the distribution of the estate in the normal way.
- (3) A condition which makes an offer of composition subject to the rehabilitation of the insolvent is of no effect.

18.3 Acceptance of section 119 composition

In the **prescribed** case of *Prinsloo en 'n ander v Van Zyl* NO 1967 (1) SA 581 (T), the offer of composition was accepted only by a majority in value. So there was no valid acceptance, and thus no valid composition.

Activity 4

This activity will give you practice in identifying the main features of a case which you have to read.

Summarise *Prinsloo* for yourself by stating the facts in two concise sentences, and the *ratio* of the court in three sentences.

- (1) Facts
 - (a)
 - (b)
- (2) *Ratio decidendi*
 - (a)
 - (b)
 - (c)

Feedback

An important aspect of the court's decision deals with the requirements set for a valid composition according to the interpretation of section 119(7) of the Insolvency Act.

The composition is valid and binding as soon as the offer has been accepted by the required majority, but the insolvent is entitled to the Master's certificate only after payment has been made in terms of the composition or security for payment, as set in terms of the composition, has been lodged. This certificate is important when the insolvent wishes to apply for rehabilitation in terms of section 124(1) of the Insolvency Act (see Hockly 18.4.5).

18.4.1 All concurrent creditors bound

Note that all creditors are bound by the composition, except in so far as their claims are secured or otherwise preferent. In so far as a claim is secured or preferent, the creditor is bound by the composition only if he or she waived his or her security or preference in writing and thereby became a concurrent creditor. Because a secured creditor cannot be bound by a composition in so far as his or her claim is secured, it is logical that he or she may not vote on a composition, with regard to the secured portion of his or her claim (see Hockly 18.3). Yet it is strange that a preferent creditor may still vote on the acceptance of a composition with regard to his or her full claim, although he or she is not bound by the composition.

According to general principles, the liability of a surety for a concurrent debt of the insolvent would fall away when a composition is accepted. The reason for this result is that the composition has the effect of discharging the original debt by replacing it with another. As an exception to this general rule, however, section 120(3) of the Insolvency Act expressly states that the liability of a surety is **not affected** by the acceptance of a composition.

SELF-TEST QUESTIONS

- (1) A has a concurrent claim of R5 000 against the insolvent estate. B bound himself as surety for this debt towards A. Assume that a composition is accepted in terms of which the insolvent undertakes to pay 50 cents in the rand of all concurrent claims. Explain A's position. (2)
- (2) A, B and C are concurrent creditors of Tenza for R6 000, R1 500 and R4 000 respectively. D and F are preferent creditors for R2 000 and R1 000 respectively. D has waived his preference. The insolvent, Tenza, makes a written offer of composition to his creditors. A, C and D vote in favour of the composition. Explain whether the composition is valid. (5)
- (3) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

If the creditors accept an offer of compromise because they feel sorry for the insolvent, even though they know that the offer of compromise is not in the interests of the estate or for the benefit of creditors generally, the acceptance is not valid.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) A may claim R2 500 in terms of the composition and may still recover the remaining R2 500 of the original claim from the surety, B.
- (2) No. Although more than three-quarters of the creditors in **value** accepted the composition this was fewer than three-quarters in **number**. According to *Prinsloo en 'n ander v Van Zyl NO 1967 (1) SA 581 (T)*, the requirements are three-quarters in number **and** value. The composition is therefore not valid.

In regard to question (2), you should remember that the composition must be accepted by “creditors whose votes amount to not less than three-fourths in value and three-fourths in number (calculated in accordance with the provisions of section fifty-two) of the votes of all the creditors who proved claims against the estate” (s 119(7) of the Insolvency Act). For a creditor’s vote to be reckoned in number, his or her claim must now be worth at least R1 000 (see s 52(3) of the Insolvency Act, mentioned in Hockly 9.3.2, which you do not have to study). So in question (2), the creditors’ votes may be analysed as follows:

Names of creditors	Types of creditors	Number of creditors for or against composition	Value of claims for or against composition
A	Concurrent	In favour	R6 000
B	Concurrent	Against	R1 500
C	Concurrent	In favour	R4 000
D	Preferent (but waived preference)	In favour	R2 000
F	Preferent	Against	R1 000

Of these creditors who proved claims against Tenza’s insolvent estate, more than 75 percent in value voted in favour of the composition (ie, A worth R6 000, C worth R4 000, and D worth R2 000, a total of R12 000, as opposed to B worth R1 500 and F worth R1 000, thus a total of R2 500). Nevertheless, three creditors in number voted in favour of the composition (A, C, and D) and two creditors in number voted against the composition (B and F). So 60 percent of the creditors in number supported the composition. This percentage did not meet the requirement that the composition must be supported by at least 75 percent of the creditors in number of the votes of all the creditors who proved claims against the estate (ie, A, B, C, D, and F, all of whom proved claims against the estate).

- (3) This statement is true. See Hockly 18.3. The resolution to accept the offer of compromise must be taken bona fide and in the interests of the general body of creditors. In *Zulman & others v Schultz 1924 TPD 24*, it was held that where creditors accept an offer of compromise, not in the honest belief that the compromise is in the interests of the estate or for the benefit of creditors generally, but from feelings of pity or benevolence towards the insolvent, the acceptance is invalid.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 20

REHABILITATION

Fortunately for Tenza, even if his attempt at entering into a composition with his creditors has failed (see self-test question (2) in study unit 19 above), the period during which an insolvent remains under sequestration does not last forever. In this study unit, you will learn about the requirements of rehabilitation, the process by which the period of sequestration comes to an end and the insolvent may then regain his or her full status as a member of society.

After completing this study unit you should be able to

- indicate when an insolvent may apply for rehabilitation
- discuss the consequences of rehabilitation
- explain in which circumstances the court will make a declaratory order with respect to property which formed part of the insolvent estate
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit.

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly 19.1, 19.2.1, 19.2.5, 19.3, and 19.4.

Omit Hockly 19.2.2 up to and including 19.2.4, and also 19.2.6.

Also study the following:

Vorster v Steyn NO en andere 1981 (2) SA 831 (O) (case [45] in Loubser)

At the outset, you should note that it is the insolvent **estate** that is sequestered, but that it is the insolvent **person** that is rehabilitated. Rehabilitation enables the insolvent to make a new beginning. Rehabilitation discharges the insolvent from all disabilities that flowed from the sequestration of his estate, and debts which arose before sequestration may no longer be recovered from him, although the creditors retain their rights against the insolvent estate itself (see further Hockly 19.3).

9.1 Automatic rehabilitation after 10 years

There may be various reasons why an interested person wishes to apply for an order that automatic rehabilitation should not take place after the lapse of 10 years. It may, for example, happen that only just before the completion of the 10-year period the trustee becomes aware of some possible impeachable dispositions. It may also happen that the insolvent's conditional rights as fideicommissary heir (see the definition of "property" in s 2 of the Insolvency Act) will probably become unconditional shortly after the lapse of the period of 10 years.

19.2.1 Circumstances in which rehabilitation may be sought

Note that the grounds for rehabilitation which are mentioned in section 124(1), (2), (3) and (5) of the Insolvency Act are independent from one another. So if a composition has been accepted and it appears from the Master's certificate that at least 50 cents in the rand has been paid in terms of the composition (see s 124(1)), an application for rehabilitation may be made even if the insolvent has been convicted of some fraudulent act with respect to his insolvency (see s 124(2)(c)). But the conviction is, of course, still a factor which the court will take into account when it has to decide on the application.

As regards section 124(2)(c), you should note that it is not a conviction of any offence that makes an application for rehabilitation within five years after the conviction impossible. Section 124(2)(c) refers to sections 132, 133 and 134 of the Insolvency Act, which concern the concealment or destruction of books or assets, the concealment of liabilities or a false representation concerning assets, and the failure to keep proper records.

If application for rehabilitation is made in terms of section 124(2) of the Insolvency Act and fewer than four years have lapsed since the date of sequestration, the Master must specifically recommend the insolvent's rehabilitation before the court may consider the application (see Hockly 19.2.1(ii), third bullet). It will be insufficient if the Master simply says that he or she abides by the decision of the court, or that he or she has no objection to the rehabilitation of the insolvent (cf *Ex parte Porritt* 1991 (3) SA 866 (N); *Ex parte Anderson* 1995 (1) SA 40 (SE)).

Note that if no claims have been proved against the estate (see Hockly 19.2.1(iii)), and no trustee has accordingly been elected, the insolvent will often have a choice whether to apply for **rehabilitation** in terms of section 124(3) of the Insolvency Act, or for the **setting aside** of the sequestration order in terms of section 54(5) of the Insolvency Act (see Hockly 2.8). There is an important difference in the consequences of the two possibilities. In the case of rehabilitation, the insolvent will be discharged from all pre-sequestration debts, but in the case of setting aside, all debts which he or she had will remain in existence.

19.3 Effect of rehabilitation

It is important to note that, in principle, rehabilitation has **prospective** operation only; in other words, rehabilitation applies with effect in the future. In particular, the assets of the insolvent estate which have vested in the trustee and which have not yet been realised and distributed remain vested in the trustee for application to the benefit of the creditors. The exception to this rule is rehabilitation because no claims have been proved after six months (see s 124(3) of the Insolvency Act and Hockly 19.2.1(iii)).

Because the debtor is no longer an insolvent after rehabilitation everything that he or she acquires after rehabilitation accrues to him or her personally, and does not fall into the insolvent estate. Nor may the Master any longer make an order in terms of section 23(5) of the Insolvency Act with respect to the former insolvent's earnings after rehabilitation (see Hockly 5.3.2).

19.4 Declaratory order regarding property

In connection with “declaratory orders”, you should carefully study the **prescribed** judgment in *Vorster v Steyn NO en andere* 1981 (2) SA 831 (O).

As you have seen (Hockly 5.3), some property is excluded from the insolvent estate by the Insolvency Act itself. The insolvent is entitled to this property in any event, and need not ask the court to award that property to him or her. But sometimes there are assets which did vest in the trustee in terms of section 20 of the Insolvency Act, but which have not yet been applied to the benefit of the creditors when the insolvent applies for rehabilitation. It should be clear that the insolvent has no right to this property. Under section 129(3)(c) of the Insolvency Act, this property remains vested in the trustee even after rehabilitation, in order to be realised for the benefit of the creditors (see Hockly 19.3). The only way in which the insolvent may acquire this property for his or her own benefit is if he or she can satisfy the court that the trustee and creditors have **waived** their rights to the property. In other words, the insolvent is obliged to prove that the trustee and creditors knew about their rights to the property concerned but have not enforced those rights. The procedure to be followed in this application for a declaratory order is aimed at providing proof that the trustee and creditors have indeed waived their rights by not objecting to the order.

The court has no discretion to make such an order. Even if only one creditor objects to the making of the order the court is bound to dismiss the application. It was argued in *Vorster* that section 127(2) of the Insolvency Act gives the court a discretion to make such an order part of a rehabilitation order, even if a creditor objects to it. The court correctly rejected this argument. It is clear that section 127(2) empowers the court to make a rehabilitation order subject to conditions which burden the insolvent (eg, the payment of a further dividend). But section 127(2) does not empower the court simply to award an asset that forms part of the insolvent estate to the insolvent personally, thereby benefiting him.

Activity 1

This activity will help you understand not only the importance of the requirement of waiver in the granting of a declaratory order, but also the steps that a testator may take to prevent his property from passing to the creditors and trustee of the insolvent beneficiary.

- (1) Explain why an insolvent applying for a declaratory order must notify the creditors of his intention to do so.
- (2) Explain what, according to the court in *Vorster v Steyn NO en andere*, a testator may do to prevent his bequest from falling into an insolvent estate.

Feedback

- (1) The basis for a declaratory order is that the creditors have waived their rights with respect to the property. The reason for the requirement is that creditors cannot waive rights of which they are unaware.
- (2) The court agrees with *Mars: The Law of Insolvency in South Africa* 6 ed (1968) that an inheritance will not fall into the insolvent estate if the testator appoints another beneficiary who should receive the inheritance if the original beneficiary is insolvent. A second possibility is for the will to provide that, in case of insolvency of the beneficiary, the executors will have the exclusive discretion to grant the inheritance to another person.

(Remember that, as a result of the decision in *Wessels NO v De Jager en 'n ander NNO* 2000 (4) SA 924 (SCA), the beneficiary may even repudiate the inheritance or the bequest, which does not therefore fall into the insolvent estate (see Hockly 5.2).)

SELF-TEST QUESTIONS

- (1) D's estate was sequestrated in 2005. His concurrent creditors received no dividend and even had to pay contributions. D has not yet been rehabilitated. He has just won a motorcar to the value of R150 000 in a competition. The trustee of D's insolvent estate has heard about his good fortune and claims delivery of the car. Explain to D whether he has to deliver the car to the trustee or whether there is any possibility that he could keep it for himself.

(14)
- (2) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

If Tenza, before becoming insolvent, had thrown away all his financial records and had no way of knowing how much he owed his creditors, the court eventually hearing Tenza's application for rehabilitation might decide that, because he was now earning a substantial remuneration package in his new job, he should be rehabilitated only if he paid the balance of the trustee's fees.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) Your answer to this question should consist of two parts. First, attention should be given to whether the car forms part of the insolvent estate. In this regard the provisions of sections 20 and 23 of the Insolvency Act, which are considered in Hockly chapter 5, are relevant. The second part of your answer should concern declaratory orders.

All assets of the insolvent at the time of sequestration, and all assets that the insolvent acquires during sequestration, that is before rehabilitation, fall into the insolvent estate, unless the property is specifically excluded by the Insolvency Act in terms of section 23. The car that D has won is not excluded by the Act and thus

forms part of the insolvent estate. Even on rehabilitation the assets in the insolvent estate do not (subject to one exception) pass to the insolvent again. But D may approach the court for a declaratory order which would enable him to keep the car. He may apply for this order when he applies for rehabilitation. The basis of a declaratory order is that the creditors have waived their rights with respect to the property. As was decided in *Vorster v Steyn NO en andere*, the court has no discretion to make a declaratory order if one or more creditors are opposed to it. To obtain a declaratory order, D will have to comply with the requirements as set out in *Ex parte Steele* 1948 (1) SA 1203 (W) at 1204 and *Ex parte Kriel* 1949 (1) SA 971 (O) at 976. These requirements are as follows:

- (a) He must give notice in the *Government Gazette* of his intention to apply for the order, and indicate in what circumstances he acquired the car.
- (b) He must give copies of the above-mentioned notice to the Master, the trustee, and all unpaid creditors. If he cannot trace a creditor, he should explain what steps he has taken to trace him.
- (c) He must indicate that the creditors and the trustee have been fully informed about the property and that they have laid no claim to the property.

In this case, where the creditors had to pay a contribution, the chances are good that they will not waive their rights to the property. And even if they do not object to the declaratory order, the court will perhaps make D's rehabilitation subject to the repayment of the contributions to the creditors.

- (2) This statement is true. See Hockly 19.2.5(ii) concerning the grant of rehabilitation subject to a condition. In *Ex parte Matthee* 1975 (3) SA 804 (O), the applicant, prior to insolvency, had allowed his financial affairs to deteriorate into a chaotic state. When he applied for rehabilitation he was in permanent employment and had accumulated assets out of his earnings. The court held that his rehabilitation should be granted subject to his paying, among other things, the balance of the trustee's fees. In the present case, Tenza allowed his financial affairs to degenerate into chaos because he threw away all his financial records so that he had no way of knowing how much he owed his creditors. The court hearing Tenza's application for rehabilitation would be entitled to impose a similar condition (Tenza's payment of the balance of the trustee's fees) on the grant of rehabilitation.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 21

PARTNERSHIP AND SEQUESTRATION

In study unit 1, you were introduced to the sequestration of the estate of a “debtor”. There you learned that the definition of the word “debtor” in section 2 of the Insolvency Act includes a partnership or the estate of a partnership. A partnership may be described as the legal relationship arising from a contract between at least two, but usually not more than 20, persons, by which the partners agree to contribute to a common business in order to make a profit that they will divide among themselves. Now, in this study unit, we shall examine how insolvency law applies to the sequestration of the partnership estate.

After completing this study unit you should be able to:

- name the applicants and describe the procedure for the voluntary surrender of a partnership estate
- name the applicants, describe the procedure, and state the law on the effect of the compulsory sequestration of a partnership estate
- explain the law on the effect of the sequestration of a partner’s estate
- state the law on composition by a partner
- distinguish between the proving of claims against the partnership estate and against the insolvent estates of the partners
- state the law on the surplus in the partnership estate and the surplus in a partner’s estate
- explain the law on the rehabilitation of a partner
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly chapter 20 up to and including 20.8.

Omit Hockly 20.9.

Without the specific provisions in the Insolvency Act it would not have been possible to sequestrate a partnership, because a partnership is not considered to be a natural person. It

is an established rule that a creditor of a partnership must sue the partnership itself for the debt and that he must first attach the partnership assets. Only when the proceeds of the partnership debts are insufficient to satisfy the debt may the creditor attach the individual partners' assets for execution. Similar rules which bring about a degree of separation between the partnership and the individual partners are found in the Insolvency Act.

20.1 Voluntary surrender of partnership estate

You will notice that there are exceptions to the rule that an individual partner's estate must be sequestrated simultaneously when the partnership estate is sequestrated. Because there are probably no more partnerships under the repealed Natal and Cape legislation we shall ignore "special partnerships". But it is important to know what a partnership *en commandite* or a partner *en commandite* is. A partnership *en commandite* has one or more ordinary partners and one or more partners *en commandite*. A partner *en commandite*, unlike an ordinary partner, does not participate in the management and business of the partnership. He merely makes an initial contribution (either money or goods) to the partnership assets and leaves it to the other partners to manage the partnership. Although like the ordinary partners he shares in the profits of the partnership he is not liable to the partnership creditors for the partnership debts. The only risk which he runs is the loss of his initial contribution to the partnership property in the form of money or goods. Because a partner *en commandite* cannot be held liable for partnership debts there is no reason that his private estate should be sequestrated when the partnership estate is sequestrated.

20.4.2 Composition by partner

Because the trustee of the partnership estate is entitled to any surplus out of the partner's estate after payment to that partner's private creditors (see Hockly 20.7), the interest of the partnership creditors must be protected if a partner has entered into a composition with his private creditors. The protection is that the trustee of the partnership estate has a choice of taking over all the private assets of that partner, provided that the trustee is prepared to carry out the composition.

20.5 Proof of claims

The most important provision regarding the simultaneous sequestration of a partnership estate and the estates of the individual partners is section 49(1) of the Insolvency Act. Subject to what is stated in Hockly 20.7, private claims can be proved only against the particular private estate, and partnership claims only against the partnership estate. But there is one exception to this rule. The Commissioner for the South African Revenue Service has a preferent claim with regard to arrear income taxes owed by an insolvent (Hockly 16.3.2(vii)). This provision also applies to an insolvent partnership. In so far as the arrear taxes apply to income derived from the partnership the Commissioner may prove his claim against the partner's estate and against the partnership estate.

Activity 1

In this activity, we test your ability to decide which claims are proved against the partnership estate and which claims are proved against the private estates of the partners.

B and C run a tailor's business together – the A Partnership. The partnership estate and the private estates of the two partners have all been sequestrated. The creditors' claims are the following:

G Hospital: skiing accident by C: R200 000

H Mills: fabric supplied: R30 000

J Needlemakers: needles supplied: R5 000

K Caterers: food for the wedding reception of B's daughter: R20 000

Commissioner for the South African Revenue Service: income tax on B's earnings as a member of A Partnership: R2 000

Commissioner for the South African Revenue Service: income tax on C's earnings as a part-time teacher of mathematics: R200

Indicate which of the above claims may be proved against which of the following, and in brackets give brief reasons.

A Partnership	Ben	Cary

Feedback

A Partnership	Ben	Cary
H Mills: fabric supplied: R30 000 (partnership debt for goods supplied for partnership business)	K Caterers: food for the wedding reception of B's daughter: R20 000 (private debt for food supplied not for partnership business but for private entertainment)	G Hospital: skiing accident by C: R200 000 (private debt for hospitalisation not falling within partnership business)
J Needlemakers: needles supplied: R5 000 (partnership debt for goods supplied for partnership business)		
Commissioner for the South African Revenue Service: income tax on B's earnings as a member of A partnership: R2 000 (income tax on income obtained from the partnership)	Commissioner for the South African Revenue Service: income tax on B's earnings as a member of A partnership: R2 000 (income tax on income obtained from the partnership)	Commissioner for the South African Revenue Service: income tax on C's earnings as a part-time teacher of mathematics: R200 (income tax on income NOT obtained from the partnership)

20.7 Surplus in either estate

Consider the following example: Andile and Bradley are partners in a partnership known as Sunshine & Co. In terms of the partnership contract, they are equal partners in all respects. This implies that the nett assets of the partnership will be divided equally between them on the dissolution of the partnership. On the application of a partnership creditor, the partnership estate and thus the estates of Andile and Bradley are sequestrated. After confirmation of the final account of all three estates it appears that the concurrent creditors of Sunshine & Co received 50 cents in the rand, and Andile's concurrent creditors received 70 cents in the rand. It also appears that the creditors of Bradley were fully paid and that a surplus of R20 000 exists in his estate. The trustee of the partnership estate may now claim this R20 000 surplus to pay a larger dividend to the partnership creditors. But if the total amount required to pay the partnership creditors is less than the R20 000 the trustee may claim only the lesser amount from Bradley's estate.

Assume that the position in our example was as follows: The concurrent creditors of Andile received a dividend of 50 cents in the rand from Andile's estate. Bradley's concurrent creditors also received a dividend of 50 cents in the rand. There is, however, a surplus of R20 000 in the partnership's estate, after payment in full of all partnership debts. Because Andile and Bradley would each have been entitled to half this surplus if their estates had not been sequestrated, Andile's trustee and Bradley's trustee may each claim R10 000 from the partnership. These sums fall into the insolvent estates of Andile and Bradley and will be further divided among their creditors.

SELF-TEST QUESTIONS

- (1) A, B, and C are partners in a plumbing business. The partnership owes R10 000 to creditor D for pipes supplied, and B owes R20 000 to creditor E for home furnishings which he ordered as a wedding present for Mrs B. A writes D a letter stating that the partnership cannot pay the R10 000 debt. E takes judgment against B for payment of the debt, but the judgment remains unpaid. Discuss whether the partnership estate may be compulsorily sequestrated because of A's letter to D, or E's judgment against B, or both? (6)
- (2) Change the facts in question (1) slightly: suppose that the partnership was able to pay D the R10 000. How would B's inability to pay the R20 000 judgment debt affect the partnership between A, B, and C? (4)
- (3) The estate of K Partnership has been sequestrated, and also the private estates of its two partners, P and Q. The creditors of P's private estate have accepted his offer of composition for payment of a dividend of 70 cents in the rand. Describe the procedure that should be followed. (3)
- (4) Suppose that P's private estate (in question (3) above) includes a valuable painting and a sports car that the trustee of K Partnership wishes to acquire. Explain what that trustee should do. (4)

- (5) Which requirements must be met for the rehabilitation of a partnership estate? (1)
- (6) The B Partnership estate and the private estates of partners L and M were all sequestrated. Now the liabilities of the partnership estate are R70 000, and the assets R30 000. L's private estate did owe creditor Q R15 000 and creditor S R20 000, but L has since managed to pay both these creditors in full. In other words, with reference to section 124(5) of the Insolvency Act, it would mean that L has paid those claims in full, with interest on them from the date of sequestration, and has also paid all the costs of the sequestration of his private estate. L consults you about the prospects of rehabilitation; in particular, he is worried that the partnership's unpaid debts of R40 000 may prevent his rehabilitation. Advise L. (6)
- (7) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

When granting an order for the compulsory sequestration of the Absolutely Wonderful Partnership estate, the court need not simultaneously sequester the private estates of the partners who live in Saudi Arabia, and the private estates of the partners who initially contributed money to the partnership but do not take part in the management and business of the partnership.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) The partnership estate may be sequestrated on the grounds of A's letter to D: the letter constitutes notice by a partner acting in his capacity as a partner that the partnership is unable to pay its debts, and its sending is therefore an act of insolvency (s 8(g)). By contrast, the partnership estate may not be sequestrated on the grounds of B's failure to satisfy the judgment in favour of E: although this failure also constitutes an act of insolvency (s 8(b) of the Insolvency Act), B did not act in his capacity as a partner when ordering the home furnishings as a wedding present for Mrs B, because the purchase of those furnishings falls outside the sphere of the partnership business.
- (2) B's failure to satisfy the judgment is a ground for the sequestration of B's private estate (s 8(b) of the Insolvency Act). Neither the partnership estate nor the private estates of A and C need be sequestrated. Yet the sequestration of B's estate will *ipso iure* (by operation of law) cause the dissolution of the partnership among A, B, and C. The remaining partners (A and C) may then form a new partnership between themselves that will not include B.
- (3) A copy of the deed of composition and a written notice of the acceptance by P's creditors of P's offer of composition must be sent by the trustee of P's private estate to the trustee of the K Partnership estate. Then the acceptance of that offer of composition will not take effect until six weeks have passed after the trustee of the K Partnership estate has received the notice and the deed.

If the trustee of P's private estate is also the trustee of the K Partnership estate the offer of composition will take effect six weeks after the date on which the creditors of P's private estate accepted P's offer of composition (s 121(1) of the Insolvency Act).

- (4) Within the six-week period set by section 121(1) of the Insolvency Act, the trustee of the K Partnership estate may take over the assets of P's private estate (including the painting and the car). The requirement for doing so is that the trustee must perform P's obligations in terms of the deed of composition, except any obligations to render a service or obligations that only P can perform. The facts do not indicate that the composition requires the giving of any specific security, but if there are any such terms, the Master must decide what other security the trustee of the K Partnership estate may give in lieu of that specific security (s 121(2)).
- (5) Because a partnership cannot be rehabilitated (s 128 of the Insolvency Act), no requirements for such a legal impossibility exist.
- (6) L may apply for rehabilitation – not as a partner, but as an ordinary debtor whose estate has been sequestrated. The partnership's unpaid debts of R40 000 will not prevent his rehabilitation: the court may order his rehabilitation even if there is a deficiency in the partnership estate or if that estate has not yet been finalised. The court order for L's rehabilitation will release him from liability for the partnership's debts of R40 000 and for the debts of his private estate. (As regards the procedure for rehabilitation, L should, not less than three weeks before making the application, give written notice to the Master and to the trustee of his insolvent estate of his intention to make the application (see the proviso to s 124(5) of the Insolvency Act).)
- (7) This statement is true. If the court sequestrates the estate of a partnership it is bound to sequester at the same time the private estate of every member of the partnership, except a partner not residing in the Republic, and an anonymous partner. See Hockly 20.2. In the present case, the partners residing in Saudi Arabia do not reside in South Africa, and (as we have explained in this study unit in connection with Hockly 20.1), the partners who initially contributed money to the partnership but do not take part in the management and business of the partnership are anonymous partners (*partners en commandite*).

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Omit Hockly chapter 21 on insolvent deceased estates.

Omit Hockly chapter 22 on offences.

Study unit 22

WINDING-UP OF COMPANIES

In this study unit, we introduce you to the winding-up of a company, a process also referred to as the liquidation of a company. A company is a juristic person. Remember that the estates of natural persons (human beings) are sequestrated, but that companies (being juristic persons) are liquidated. Remember also that both **solvent** and **insolvent** companies may be wound up in certain circumstances. After a company has been wound up (liquidated) it is dissolved by the Registrar of Companies. On dissolution, the company ceases to exist.

After completing this study unit you should be able to

- describe the different modes of winding-up and explain when each one is used
- discuss the grounds for winding-up by the court
- explain which parties may apply to the court for winding-up
- set out the consequences of a winding-up order
- set out the principles concerning the appointment and discharge of liquidators
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly chapter 23 up to and including 23.4.5, and 23.6 up to and including 23.6.4, and 23.10.

Omit Hockly 23.5 up to and including 23.5.3, and 23.7 up to and including 23.7.8, and 23.8 up to and including 23.9, and 23.11 to the end of the chapter.

Also study the following:

***Rand Air (Pty) Ltd v Ray Bester Investments (Pty) Ltd* 1985 (2) SA 345 (W) (case [24] in Loubser)**

You will note that solvent and insolvent companies may be wound up. Always note which provisions apply only if the company is unable to pay its debts.

Background information about companies

At this point, we need to give you some background information on companies in order to help you understand the winding-up of this kind of business entity. Much of the law relating to companies is contained in a special statute, the Companies Act 61 of 1973, as supplemented by the relevant principles of the common law. A company is a fictitious person that has a legal personality separate from the members of the company. One effect of this principle of the separate legal personality of the company is that the assets and liabilities of the company are the assets and liabilities of the company, and not of the members of the company. The most important kind of company for our present purposes is the company with a share capital. This share capital is the money that the members of the company contribute to the company as a reserve fund. In return for these contributions to the share capital these members receive shares in the company, and so they are called the shareholders of the company. There are two kinds of companies with share capital, namely

- (1) the public company
- (2) the private company

The name of a **public company** must end with the word “**Limited**”, or the abbreviation “**Ltd**”. A public company must have at least seven members (shareholders); if this number of members falls below seven, this change is a possible ground for the court to wind up the company (see Hockly 23.2.2(iv)). The shares in a public company may usually be transferred without restrictions, and these shares are often listed on the JSE Ltd (“JSE”). (You will find the website of the JSE Ltd (“JSE”) at <http://www.jse.co.za/>.)

A **private company** has a name that must end with the words “**(Proprietary) Limited**”, or the abbreviation “**(Pty) Ltd**”. A private company must have at least one member, but not more than 50 members. There must also be restrictions on the ability to transfer the shares of a private company. Accordingly, the shares of a private company are not listed on the JSE Ltd (“JSE”).

The human beings (the natural persons) who administer the business of the company are its directors.

The members of a company are its shareholders, so do not make the mistake of calling them partners. Nor should you refer to the directors of a company as the partners, because the directors are not partners. Nor should you refer to a company as a partnership, because a company is not a partnership.

23.2.2 When company may be wound up by court

23.2.2(i) Special resolution

This special resolution must be lodged with the Registrar of Companies, and be registered by him within six months after the resolution was adopted. If this is not done, the resolution lapses and may no longer serve as a ground for winding-up, unless the court orders otherwise (s 202 of the Companies Act). Apart from this requirement, a special resolution acquires legal force only when it has been registered (s 203(1)). An application for winding-

up on this ground may therefore not be brought immediately after the resolution has been adopted, but only after its **registration**.

23.2.2(iv) Public company's members less than seven

You will probably wonder why the decrease in the number of members of a **public** company to below seven is a ground for the winding-up of the company. The answer lies in section 66 of the Companies Act. According to section 66, a member of a public company (except a wholly-owned subsidiary) is personally liable for the company's debts if the company carries on business for a period of more than six months while it has fewer than seven members. Such a member is then liable for the debts incurred after the expiry of the period of six months, if he knew that the company carried on business while it had fewer than seven members. This being the case, such a member must be enabled to prevent his becoming liable for the company's debts in terms of section 66. This he may do by applying for the winding-up of the company.

23.2.2(vi) Inability to pay debts

You will notice that section 345(1) of the Companies Act provides for three ways in which the company's inability to pay its debts may be proved. Concerning the company's failure to respond to a demand (s 345(1)(a) of the Companies Act), pay special attention to the **prescribed** case of *Rand Air (Pty) Ltd v Ray Bester Investments (Pty) Ltd* 1985 (2) SA 345 (W). In that case, it was decided, among other things, that a **summons** is not a demand as contemplated in section 345(1)(a). A summons is a document in which the **sheriff** is ordered to convey certain information to the debtor. It is not a demand to pay addressed to the debtor himself. Moreover, section 345(1)(b) (on proof of inability to pay debts by means of a return by the sheriff to the effect that he could not find sufficient disposable property to comply with a judgment) would have been unnecessary if a summons already qualified as a demand in terms of section 345(1)(a).

23.2.2(viii) Just and equitable

In connection with Hockly 23.2.2(viii), you should also study the **prescribed** *Rand Air* judgment. Note that the "just and equitable" ground is separate from all the other grounds mentioned in section 344 of the Companies Act. If the applicant's real reason for the application is the company's inability to pay its debts he should rely on that ground. He may not allege that it will be to the advantage of the creditors if the company's affairs are investigated by a liquidator, and that it will therefore be just and equitable to wind up the company.

23.2.3 Parties who may apply

23.2.3(i) The company

The company itself may apply for its own winding-up. When the general meeting of members, by means of a special resolution, has resolved that the company be wound up by the court, the special resolution is a ground for winding-up as well as an authority to the directors to make the application. If a different ground for winding-up is relied upon, authority will have to be given to make the application. It is clear that the general meeting of members

may give such authority. As you can deduce from Hockly 23.2.3(i), however, there is a measure of uncertainty on whether the board of directors may, on their own authority, decide to apply for winding-up on behalf of the company.

Activity 1

This activity will help you understand which parties may apply to the court for the winding-up of a company.

- (1) Name the parties that may apply to the court for the winding-up of a company on the ground of the company's inability to pay its debts.
- (2) Explain whether a director of a company may apply for the winding-up of that company.

Feedback

- (1) The company itself, one or more creditors, the judicial manager, or a combination of these persons, may apply for the winding-up of a company on the ground of the company's inability to pay its debts. Note that members may not bring an application for winding-up on this ground. The Master may apply only for the conversion of a voluntary winding-up into a winding-up by the court.
- (2) A director is not one of the parties who may apply to the court for winding-up. The company itself may apply, and possibly on the strength of a resolution of the board of directors. But there is still uncertainty about which organ of the company must grant the authority.

23.2.4 Steps prior to application

Sections 346 and 347 of the Companies Act 1973 have also been amended by the Insolvency Second Amendment Act 69 of 2002 in virtually the same way as the corresponding sections of the Insolvency Act 1936 have been amended. Sections 346 and 347 of the Companies Act thus provide for the service of documents on the relevant parties when a company is liquidated (cf ss 4(2), 9(4A), and 11 of the Insolvency Act), and they also allow compensation, among other things, for the abuse of the court's procedure for the winding up of companies (see s 15 of the Insolvency Act). These changes apply to Hockly 23.2.4. The changes themselves are mentioned above in this Study Guide in relation to Hockly 2.3.2, 3.2.1, 3.2.3, and 3.5 above.

23.2.5 Powers of court

The court will not easily refuse a winding-up order if a creditor has proved that the company is unable to pay its debts. If a member applies on a ground other than inability to pay debts (see Hockly 23.2.2(iv)), the principle applies that other available legal remedies enjoy preference. An example of such an alternative legal remedy is an order that a shareholder's shares be bought by the company or the remaining shareholders (Hockly 23.2.2(viii)).

23.3 Voluntary winding-up

In the case of a winding-up by the court, it is **the court** that decides whether the company will be placed in liquidation. In the case of a **voluntary winding-up**, however, the court is not involved at all. The **general meeting of members** places the company in winding-up by passing an appropriate special resolution. You will notice that there are two kinds of voluntary winding-up. Note that in **both** cases it is the general meeting of members that places the company in liquidation by way of a special resolution. The difference between a members' voluntary winding-up and a creditors' voluntary winding-up comes into play only **after** the special resolution concerned has been passed and registered. In the case of a members' voluntary winding-up, the creditors really have no interest in the liquidation process, because security for the payment in full of their claims against the company would have been provided (see Hockly 23.3.1). Accordingly, a members' voluntary winding-up takes place under the control of the general meeting of members, and a creditors' voluntary winding-up takes place under the control of the creditors (see s 386(3) of the Companies Act).

23.3.1 Members' voluntary winding-up

This mode of winding-up is a clear example of a case where a solvent company can be wound up. The winding-up is simply the process used to distribute the assets of the company among the shareholders, after provision has been made for the payment of outstanding debts.

23.3.2 Creditors' voluntary winding-up

Because an application to court is avoided, voluntary winding-up may bring about a saving of costs. But the Master may intervene and convert the voluntary winding-up into a winding-up by the court (s 346(1)(e) of the Companies Act).

23.4.1 Commencement of winding-up

The provision in section 348 of the Companies Act that a winding-up by the court is deemed to commence "at the time of the presentation to the court of the application for the winding-up" is very important when it comes to applying the provisions of the Insolvency Act concerning voidable dispositions to a company which is being wound up and is unable to pay its debts.

Activity 2

Consider the following example of the application of section 348 in the context of voidable dispositions: ABC Limited is a company which was wound up by the court on 26 June 2008, and which is unable to pay its debts. The liquidator wishes to have a certain disposition made by the company on 20 December 2007 set aside. It appears that the application for winding-up was filed with the Registrar of the Court on 23 May 2008.

Now answer the following two questions:

- (1) Explain whether the liquidator may rely on section 29 of the Insolvency Act (as applied by s 340 of the Companies Act) in order to have the disposition set aside as a voidable preference.
- (2) Explain how your answer would differ if ABC were a natural person whose estate was provisionally sequestrated on 28 June 2008 and finally sequestrated on 13 July 2008.

Feedback

- (1) Because the winding-up is deemed to have commenced on 23 May 2008, the liquidator will in fact be able to prove that the disposition was made within six months before the winding-up of ABC Limited, although the actual winding-up order was made more than six months after the date of the disposition. Accordingly, section 29 of the Insolvency Act may be relied upon.
- (2) Had the sequestration of the estate of a natural person been involved, the trustee would not have been able to prove this requirement of section 29 of the Insolvency Act, because the sequestration order would have been made more than six months after the disposition.

23.4.3 Subsequent unauthorised dispositions void

When you study the consequences of winding-up, keep in mind the provisions of section 348 of the Companies Act in connection with the time when the winding-up is deemed to commence (see Hockly 23.4.1). It may happen that assets are disposed of or that judicial proceedings (eg, attachment of assets) are proceeded with while the parties are unaware of the registration of the special resolution or the presentation of the application to the court. Later on, the disposition or the proceedings then turn out to be void. You can imagine what problems may arise in practice in this regard!

23.10 Impeachable transactions

Keep in mind that the rules on impeachable transactions are aimed at the equal treatment of creditors in insolvency. Those rules apply **only if the company is unable to pay its debts**. Impeachable dispositions are dealt with in study units 14 to 16.

SELF-TEST QUESTIONS

- (1) Name the grounds on which a company may be wound up by the court. (8)
- (2) Discuss the “just and equitable” ground for the winding-up of a company. (14)
- (3) Explain briefly when a company is deemed to be unable to pay its debts. (12)
- (4) State the circumstances in which a members’ voluntary winding-up may take place. (6)

- (5) Describe the effect of a winding-up order on the company's property, on the transfer of shares in it, and on dispositions of property. (5)
- (6) Name six categories of persons who may not be appointed liquidator of a company. (6)
- (7) Name the grounds on which the Master may remove a liquidator from office. (5)
- (8) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

Although the assets of Bravo Co (Pty) Ltd exceed its liabilities the court may still grant an order for the winding-up of the company on the ground that one of its creditors, Colin, to whom the company owed a due debt of R1 000, left a demand for payment at the company's registered office and the company then for three weeks neglected to pay, secure, or compromise the claim to Colin's satisfaction.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) The grounds for winding-up by the court are as follows:
- (a) The company adopts a special resolution to be wound up by the court.
 - (b) The company commences business before the Registrar has issued a certificate entitling it to do so.
 - (c) The company has not commenced business within a year from its incorporation, or has suspended its business for a whole year.
 - (d) The number of members of a public company has fallen below seven.
 - (e) The company has lost 75 percent of its issued share capital, or it has become useless for its business.
 - (f) The company is unable to pay its debts.
 - (g) An external company is dissolved in its country of incorporation, or has ceased to carry on business, or is carrying on business only for the purpose of winding-up.
 - (h) It appears just and equitable that the company be wound up.

Note that it is not sufficient merely to give the headings (or other summaries in telegram style) – you should use full sentences. It is not necessary to elaborate further on each ground, for example on the circumstances in which a company is

deemed to be unable to pay its debts, or on the circumstances which have already been recognised as “just and equitable”.

- (2) Winding-up on the ground that it appears just and equitable is an independent ground which is not limited by the other grounds, but at the same time it is not an unlimited or “catch-all” ground. In *Rand Air (Pty) Ltd v Ray Bester Investments* 1985 (2) SA 345 (W), an attempt to rely on this ground as an alternative to the ground that the company was unable to pay its debts proved unsuccessful. There is no closed group of situations in which it will be just and equitable to wind up a company, and the courts accordingly still have a discretion to identify new situations. But some categories have already crystallised in case law, and, as also appears from *Rand Air (Pty) Ltd v Ray Bester Investments*, the courts are slow to extend them. In this case, the court set out the following categories:
- (a) If the main object for which the company was formed can no longer be attained. In such a case, it is said that the company’s *substratum* has disappeared. This happened in *In re Rhenosterkop Copper Co* 1908 CTR 931, because the land on which the company was to conduct mining operations contained no minerals
 - (b) If the company’s objects are illegal, or if the company was formed to defraud the persons invited to subscribe for its shares
 - (c) If there is a justifiable lack of confidence in the way in which the directors are managing the company’s affairs. This situation arose in *Moosa NO v Mavjee Bhawan (Pty) Ltd and another* 1967 (3) SA 131 (T), where a director had misled members about the advisability of a transaction because he wished to make a profit at the company’s cost
 - (d) If there is a deadlock in the management of the company: the voting power in the board of directors and the general meeting is divided, and winding-up is the only solution
 - (e) If the company is a quasi-partnership and grounds exist on which a partnership could be dissolved. This situation is encountered where the personal relationship between the members is based on good faith
 - (f) If the minority shareholders are oppressed by the controlling shareholders. Winding-up will be just and equitable only if the oppression cannot be removed by another suitable remedy.
- (3) In terms of section 345 of the Companies Act, a company is deemed unable to pay its debts if
- (a) a creditor having a claim of at least R100 which is already due leaves a demand at the company’s registered office and the company for three weeks after that has failed to pay the claim, to give security for it, or to compromise it to the satisfaction of the creditor, or

- (b) a warrant of execution or other process issued on a judgment against the company has been returned by the sheriff with an endorsement that he did not find disposable property sufficient to satisfy the judgment, or that the disposable property which he found did not, upon sale, satisfy the process, or
 - (c) it is proved to the satisfaction of the court that the company is unable to pay its debts
- (4) A members' voluntary winding-up may take place only if the company is able to pay its debts. Before the special resolution may be registered (and the winding-up may therefore commence) the company must either provide security for payment of its debts within 12 months after winding-up, or lodge the required declaration and certificate to the effect that there are no debts.
- (5) Unlike natural persons, a company does not lose its ownership, because the assets do not vest in the liquidator. The property merely falls under the control of the Master, and after that the liquidator. After the commencement of the winding-up, shares may be transferred only with the consent of the liquidator. If the company cannot pay its debts the court's permission is required for every disposition of company assets which takes place after the commencement of the winding-up.
- (6) You could have mentioned any six of the following 10 categories:
- (a) an insolvent
 - (b) a minor or other person under legal disability
 - (c) a person declared to be incapable of being appointed as a liquidator for dishonesty or abuse of his position
 - (d) a person removed from an office of trust by the court, or who has been disqualified from being a director
 - (e) a body corporate
 - (f) a person who has, at any time, been convicted of theft, fraud, forgery, uttering a forged instrument, or perjury, and has been sentenced to imprisonment without the option of a fine, or to a fine exceeding R20
 - (g) a person who has, by misrepresentation or reward, induced or attempted to induce any person to vote for, or nominate, him as liquidator, or to have him appointed liquidator
 - (h) a person who does not reside in the Republic
 - (i) a person who acted as director, officer, or auditor of the relevant company at any time within the 12 months before the winding-up

- (j) an agent authorised to vote for, or on behalf of, a creditor at a meeting of creditors who acts, or purports to act, under such authority
- (7) The grounds for removal from office by the Master are as follows:
- (a) The liquidator was not qualified for nomination or appointment, or has become disqualified, or his nomination or appointment was for any other reason illegal.
 - (b) The liquidator has not performed his duties satisfactorily.
 - (c) The liquidator's estate has become insolvent, or he has become mentally or physically incapable of acting as liquidator.
 - (d) A majority in number and value of the creditors (or the majority of members in the case of a members' voluntary winding-up) has requested the Master in writing to remove the liquidator.
 - (e) In the opinion of the Master, the liquidator is no longer suitable to act as liquidator of that company.
- (8) This statement is true. The court may wind up a company if it is unable to pay its debts as described in section 345 (s 344(f) of the Companies Act). Bravo Co (Pty) Ltd is deemed to be unable to pay its debts under section 345 because Colin, its creditor for a due debt of more than R100, left a demand for payment at the company's registered office and the company then for three weeks neglected to pay, secure, or compromise the claim to Colin's satisfaction (s 345(1)(a)). Accordingly, the court has a very limited discretion to refuse a winding-up order, even though the value of the assets of Bravo Co (Pty) Ltd exceeds the amount of its liabilities. In *ABSA Bank Ltd v Rhebokskloof (Pty) Ltd and others* 1993 (4) SA 436 (C), the company was solvent, but its farm was not readily realisable (ie, the farm could not promptly be sold for a purchase price). The fact that the company was solvent (because its assets far exceeded its debts) did not affect the right of its creditor, ABSA, to a winding-up order.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 23

JUDICIAL MANAGEMENT AND COMPROMISE

In this study unit, we shall introduce you to two methods by which financially ailing companies may be rescued. Why should these companies be rescued? The decision to wind up a company is drastic in that, after winding-up, a company will be dissolved – in picturesque language, the company will “die”. Two typical consequences of winding-up are that the employees will lose their jobs and that, if the company is insolvent, the creditors will not be paid in full what is due to them. In an attempt to avert such disastrous effects of winding-up the Companies Act provides for possible alternatives to winding-up. We shall now examine two such alternatives – judicial management and compromise.

After completing this study unit you should be able to

- describe the purpose of a judicial management order
- explain in which circumstances a judicial management order may be made
- describe the procedure by which a company enters into a compromise with its creditors
- explain the effect of a compromise sanctioned by the court
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly chapter 24 up to and including 24.1.2, and 24.1.11, and 24.2 to the end of the chapter.

Omit Hockly 24.1.3 up to and including 24.1.10, and 24.1.12 up to and including 24.1.13.

Also study the following:

***Makhuva and others v Lukoto Bus Service (Pty) Ltd and others*
1987 (3) SA 376 (V) (case [26] in Loubser)**

24.1 Judicial management

Judicial management may be seen as a half-way house between a healthy company and winding-up. Because judicial management costs money which will be wasted if the company eventually has to be wound up in any event, however, the court will have to be satisfied that there is a reasonable probability that the company will become successful again if it is placed under judicial management.

24.1.1 When company may be placed under judicial management

In connection with the circumstances in which a judicial management order may be granted, study the **prescribed** case of *Makhuva and others v Lukoto Bus Service (Pty) Ltd and others* 1987 (3) SA 376 (V). Two principles especially appear from the judgment, namely:

- (1) Judicial management may not be used merely to make a company more profitable than it is. Accordingly, the company must have **financial problems** before such an order may be considered. This also appears clearly from the requirements set out in section 427(1) of the Companies Act.
- (2) It will not be regarded as just and equitable to grant the judicial management order if the company's problems may be solved by "internal remedies". Examples of these internal remedies are to be found in three sections of the Companies Act: section 220 (on the removal of a director), section 252 (on the legal remedy against oppressive or unreasonably prejudicial behaviour towards a member), and section 266 (on the institution of a derivative action by a member on behalf of the company). Note that the "internal remedies" are granted to a **member** of the company. So, if a **creditor**, for example, applies for judicial management the application will not be dismissed merely because the applicant has not exhausted his internal remedies. Being an outsider (because he is not a member of the company), a creditor has no internal remedies that he may rely on.

24.1.2 Who may apply

You will notice that, on page 391 of the judgment in *Makhuva* (see Loubser at 144-145), the court first considers the *locus standi* (capacity to apply) of the applicants. There the court held that *locus standi* had not been proved, but in the light of the rest of the judgment, the court was nevertheless prepared to consider the case.

Activity 1

Do you agree with the argument that the applicants should allege not only that they have been registered as members for six months, but also that in terms of section 344(h) of the Companies Act it will be "just and equitable" to wind up the company? Give reasons for your answer.

Feedback

The argument does not appear to be sound. Section 346(2) of the Companies Act contains two completely different limitations.

The first limitation concerns the period of the member's membership, and its purpose obviously is to prevent a member from joining the company and then immediately taking the drastic step of applying for winding-up. So this limitation protects the other members against abuse, and the same considerations apply with respect to judicial management. This time limitation has nothing to do with the ground for winding-up.

The second limitation concerns the grounds for winding-up as such. Judicial management may be an alternative to winding-up. It does not make sense to require that a member who applies for judicial management first has to prove that there is a ground for winding-up. Section 427(2) of the Companies Act provides only that the application must be brought by someone who is entitled to bring an application for winding-up – section 427(2) does not also require the existence of a ground for winding-up. Judicial management has its own basis, and is in any event granted only if it is just and equitable to grant it. It is ironic that the court, in an application for winding-up based on section 344(h) of the Companies Act, may indeed find that judicial management will be a better way (and therefore just and equitable), and that it will therefore not be just and equitable to wind up the company! The argument that the member must also prove that there is some ground or other for winding-up therefore seems to be incorrect.

24.1.11 Impeachable dispositions

The provisions of the Insolvency Act concerning impeachable dispositions also apply when a company has been placed under judicial management, just as in the case of a winding-up of a company that is unable to pay its debts. Impeachable dispositions are dealt with in study units 14 to 16. As you have seen (Hockly 23.4.1), a winding-up is deemed to commence at the moment at which the application is filed with the Registrar. The same principle applies with respect to a judicial manager who wishes to have a disposition set aside. For the purposes of the application of the relevant provisions of the Insolvency Act, the date on which the application for judicial management is filed is deemed to correspond to the date of a sequestration order (s 436(2) of the Companies Act).

24.2 Compromise

The most important principles which you should keep in mind are that

- (1) three-quarters in value and number of the creditors who are present in person or by proxy have to vote in favour of the compromise
- (2) the compromise must be sanctioned by the court; and
- (3) all the creditors will then be bound by the compromise

Note the differences between this procedure and the composition procedure of the Insolvency Act.

SELF-TEST QUESTIONS

- (1) Indicate when the court may place a company under judicial management. (10)
- (2) Describe the procedure which must be followed for the conclusion of a binding compromise between a company and its creditors. (11)

- (3) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

The court may grant a judicial management order if there is a possibility that the company will overcome its financial predicament.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) A company may be placed under judicial management if
- (a) by reason of mismanagement or any other cause it is unable, or probably unable, to pay its debts or to meet its obligations
 - (b) the company has not become a successful concern or is prevented from becoming a successful concern
 - (c) there is a reasonable probability that, if placed under judicial management, it will be able to pay its debts and become a successful concern; and
 - (d) it is just and equitable to make such an order

In *Makhuva*, the following two principles were illustrated: the company must experience financial problems, and it will not be just and equitable to order judicial management on application by a member before internal remedies have been exhausted. It is also important that there must be a reasonable **probability** that the company will become successful, and that a mere **possibility** is insufficient.

- (2) First an application must be made to the court to call a meeting of creditors at which the proposed compromise can be considered. If the court is satisfied that the offer is prima facie fair and reasonable and should be considered by the creditors, it orders that a meeting be called. Each creditor is then notified of the meeting and provided with information sufficient to enable him to assess the merits of the proposal and any alternatives. At the meeting, the proposed compromise is voted on. Should a majority in number representing 75 percent of the value of the creditors vote in favour of the compromise, an application is brought to the court to sanction the compromise. The court has a discretion whether to sanction or to refuse the compromise.
- (3) This statement is false. One of the requirements that must be proved in an application for judicial management is that there is a reasonable **probability** that the company will be enabled to pay its debts and become a successful concern (s 427(1)). What is required is a reasonable probability, and not a mere possibility, of recovery.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Study unit 24

WINDING-UP OF CLOSE CORPORATIONS

In this study unit, we concentrate on the winding-up (liquidation) of close corporations. The winding-up of close corporations is largely regulated by the special provisions of a statute, the Close Corporations Act 69 of 1984. But the Close Corporations Act also makes certain provisions of the Companies Act applicable to close corporations. The Companies Act, in turn, also incorporates certain provisions of the Insolvency Act. So, when you deal with the winding-up of close corporations you will often find yourself having to consider the Close Corporations Act, the Companies Act, and the Insolvency Act – and even the relevant common law of insolvency that may apply to the particular facts. When studying Hockly chapter 25 on the winding-up of close corporations, keep in mind the principles concerning the winding-up of companies. Note differences between the two procedures.

After completing this study unit you should be able to

- set out the grounds for the winding-up of a close corporation by the court
- explain and apply the principles regarding repayments to the corporation
- set out the requirements for the liability of persons in terms of section 73 of the Close Corporations Act 69 of 1984
- apply the principles in this study unit in order to carry out activities and answer self-test questions such as those in this study unit

COMPULSORY STUDY MATERIALS FOR THIS STUDY UNIT

In this study unit, study Hockly chapter 25 up to and including 25.3, and 25.6, and 25.7 up to and including 25.7.3, and 25.9.

Omit Hockly 25.4 up to and including 25.5, and 25.8, and 25.10 up to and including 25.11.

Background information about close corporations

At this point, we need to give you some background information on close corporations in order to help you understand the winding-up of this kind of business entity. The name of a close corporation must end with the letters “CC”. A close corporation must have at least one member, but not more than 10 members. As a general rule, a member of a close corporation must be a natural person (a human being). Because the membership of a close corporation consists of **members**, do not make the mistake of calling them shareholders or

directors or partners. Nor should you refer to a close corporation as a company or a partnership, because a close corporation is neither a company nor a partnership.

Also note that a member of a close corporation has a **member's interest** in the close corporation. The member of a close corporation does not have a share in the close corporation; remember, the close corporation is not a company.

When the close corporation is to be registered by the Registrar of Close Corporations, each person who is to become a member must make the corporation an initial contribution of money, of property, or of services rendered in connection with and for the formation and incorporation of the corporation.

25.1 Voluntary winding-up

Except in so far as section 67 of the Close Corporations Act provides otherwise, the principles concerning the voluntary winding-up of a close corporation are exactly the same as those concerning the voluntary winding-up of a company.

25.2.2 When corporation may be wound up by court

Note that there are only four grounds for the winding-up of a close corporation by the court, but that there are eight such grounds in the case of a company.

Activity 1

Compare the circumstances in which a close corporation is deemed to be unable to pay its debts with the position in the case of a company. Is there any difference?

Feedback

Look carefully at the amount due of the creditor's claim. In the case of a company, the minimum amount is R100 (see Hockly 23.2.2(vi), first bulleted item), and in the case of a close corporation, the minimum amount is R200 (Hockly 25.2.2(iii), first bulleted item). This is the only material difference, and it may be explained by the fact that the Close Corporations Act is a later statute than the Companies Act.

25.3 Appointment of liquidator

Note that, unlike in the case of a company, no provision is made for the appointment of a provisional liquidator for a close corporation. Section 368 of the Companies Act, which deals with the appointment of a provisional liquidator, has not been made applicable to a close corporation by section 66(1) of the Close Corporations Act.

25.6 Impeachable dispositions

Always keep in mind that the principles with respect to the setting aside of dispositions in insolvency law also apply in the winding-up of companies and close corporations **that are unable to pay their debts**. Impeachable dispositions are dealt with in study units 14 to 16.

25.7.1 Payments by reason of membership

Note that section 70(2) of the Close Corporations Act places the onus on the member, or the former member concerned, to prove that the relevant payment made to him by the corporation met the requirements of section 51 of the Close Corporations Act.

Activity 2

Consider the following example of the application of section 70 of the Close Corporations Act: A and B were the original members of a close corporation. They each contributed R10 000 to the assets of the corporation. Later, the corporation paid R5 000 each to A and B as a part repayment of their initial contributions. Within two years after these repayments, however, the corporation was wound up. It turns out that there is a shortfall of R7 000 in the estate of the corporation. In the meantime, B has sold his member's interest in the corporation to A, and has accordingly ceased to be a member of the corporation. May A and B be held liable to the corporation for any repayments?

Feedback

If A and B can prove that the corporation's assets exceeded its liabilities after the payments had been made to them, and that the payments were made while the corporation was able to pay its debts as they became due and payable in the ordinary course of business, and that the payments in fact did not render the corporation unable to pay its debts as they became due and payable in the ordinary course of business, they will not have to repay anything in terms of section 70 of the Close Corporations Act. But if they cannot prove all these requirements, A will have to repay R5 000 to the corporation. Because, after such repayment by A, only R2 000 will be required to pay the corporation's debts in full, and because B is no longer a member, he will have to repay only R2 000.

25.7.2 Salary or remuneration

You must bear in mind several important differences between payments by reason of **membership**, and **salaries or remuneration**.

The all-important difference is the difference of **capacity**. This difference concerns the difference between being a **member** of the close corporation, on the one hand, and being an **employee or an officer** of the close corporation, on the other hand. Remember that it is possible that a natural person (a human being) may be a member of a close corporation, but that he or she may not necessarily work for the corporation as an employee, or be an officer of the corporation as a manager or a secretary of the close corporation.

Sometimes, however, it is possible that a member may **also** be an employee or an officer of the corporation. In that event, when you come to discuss repayments of money received before the liquidation of a close corporation, you will have to be careful to analyse the **capacity** in which the particular person was paid or remunerated. So you will have to ask whether the particular person was paid by reason of membership, or as an employee or officer, of the close corporation.

Now we shall point out **two further differences** between section 70 (on payment by reason of membership) and section 71 (on salary or remuneration):

- (1) In section 70, there is an onus of proof on the member who is paid by reason of (because of being) a member. But in the case of section 71, there is no onus of proof on the member who is an employee or officer.
- (2) In the case of section 71, the Master first has to make a determination that the payment was not bona fide or not reasonable in the circumstances: in other words, the Master has to determine that the payment was mala fide and unreasonable in the circumstances. The Master also determines whether the amount, or a part of it, has to be repaid. By contrast, in section 70 there is no requirement that the Master first has to determine the genuineness or unreasonableness of the payment.

SELF-TEST QUESTIONS

- (1) On which grounds may a close corporation be wound up by the court? (6)

- (2) X and Y are the only members of Z CC which was wound up in August 2006. The corporation's business was to repair motorcars. In May 2004, Z CC distributed the profits made in the previous financial year among the members, and each received a payment of R5 000. In October 2005, 10 percent of each member's contribution to the corporation was repaid to him. X acted as executive manager of the corporation, while Y did the repair work on the motorcars. Initially, X's monthly remuneration was R6 000, but it was doubled in January 2006. Y's salary was R5 000 per month.

It appears that Z CC is unable to pay its debts. Explain whether any of the payments made to X and Y may be recovered by the liquidator, and what will have to be proved in this regard.

(12)

- (3) Indicate whether the following statement is true or false. Use only the letters **T** or **F**; do not give a written explanation.

A composition in terms of section 72 of the Close Corporations Act may have the effect of setting aside the winding-up of the corporation.

(2)

ANSWERS TO THE SELF-TEST QUESTIONS

- (1) There are four grounds on which a close corporation may be wound up by the court, namely:
 - (a) A written resolution that the corporation should be wound up by the court, signed by members holding more than half the total votes, is taken at a meeting of members called for the purpose of considering winding-up.

- (b) The corporation does not commence its business within a year from registration, or suspends its business for a whole year.
- (c) The corporation is unable to pay its debts.
- (d) The court upon application considers it just and equitable to wind up the corporation.

Make sure that you state each ground fully. It is not sufficient simply to repeat the headings in Hockly – make sure that your answer contains a complete sentence on each ground.

- (2) The payments to X and Y may possibly be set aside in terms of sections 70 and 71 of the Close Corporations Act. Section 70 deals with **payments by reason of membership**. The payments of R5 000 to X and Y out of profits of the corporation, and the repayment of members' contributions, are payments by reason of membership. These payments may be set aside if they were made within two years before winding-up, unless the member can prove that the corporation was solvent after the payment had been made, that the payment was made while the corporation was able to pay its debts as they became due in the ordinary course of business, and that the payment did not in fact render the corporation unable to pay its debts in the ordinary course of business. The payments of R5 000 to X and Y took place more than two years before winding-up, and may therefore not be set aside in terms of section 70. As regards the repayment of part of the members' contributions, it is liable to be set aside unless X and Y can prove the aspects mentioned above.

The payment of the **salaries** may possibly be recovered under section 71. Only payments made within the period of two years before winding-up may be recovered, and only to the extent that they were not bona fide or reasonable in the circumstances. Although it is a factual question, it does not seem that the salaries of R6 000 and R5 000 respectively were unreasonable in the circumstances, or mala fide. But the drastic increase in X's salary so shortly before winding-up seems abnormal, and the increased amount is probably both unreasonable and mala fide. It therefore seems that X will have to repay the additional R6 000 that he received each month from the beginning of 2006.

- (3) This statement is true. The composition may provide for the winding-up of the corporation to be set aside by the court (s 72(11) of the Close Corporations Act). If so, the offeror may apply to the court for the relevant order. See Hockly 25.9.

FIVE-MINUTE PAPER

As the name suggests, you have five minutes to answer the following question on your own. It would be advisable to write your answer in point form.

WHAT ARE THE MOST IMPORTANT THINGS THAT YOU LEARNED IN THIS SESSION?

Omit Hockly chapter 26 on cross-border insolvency.