

MRL 301

**Law of
Insolvency**

Summaries

STUDY UNIT 1 - INTRODUCTION TO INSOLVENCY LAW

MEANING OF INSOLVENCY

- The legal test of insolvency is whether the debtor's liabilities, fairly estimated, exceed his assets, fairly valued.
- A person is not treated as an insolvent and does not suffer the legal consequences of insolvency until his estate has been sequestrated by an order of court.
- A sequestration order is a formal declaration that a debtor is insolvent.
- The order is granted in one of the following 2 ways:
 1. Voluntary surrender; and
 2. Compulsory sequestration.
- A debtor's estate is sequestrated, not the debtor himself, although both the debtor and his estate are insolvent.
- Thus when a debtor is insolvent, it has 2 possible meanings:
 1. The debtor's estate has been sequestrated; or
 2. The debtor's liabilities exceed his assets.

PURPOSE OF A SEQUESTRATION ORDER

- The main objective of a sequestration order is to ensure the orderly and equitable distribution of a debtor's assets among creditors in the order of their preference.
- Once an order of sequestration is granted, a concursum creditorum (coming together of creditors) is established and the interests of creditors as a group enjoy preference over the interests of individual creditors.
- The debtor is divested of his estate and cannot burden it with any further debts.
- Sequestration exists primarily to protect the creditors and thus a sequestration order will not be granted in the following instances:
 1. Where the sequestration will not be to the advantage of creditors;
 2. Where there is only one creditor;

- Can be anytime in the preceding 12 months, provided it is more than a "temporary stay".
- The matter may be removed or transferred by the court having jurisdiction to another court in cases where it would be equitable or convenient for the estate to be sequestrated in the transferee court (the transferee court need not have original jurisdiction).

MASTER

- A Master is appointed to each of the provincial divisions of the High Court.
- One of the most important functions that the Master exercises is the custody of all documents relating to insolvent estates.
- The Master is a "creature of statute" and as such only has the powers granted to him by the legislature – he cannot act unless empowered to do so by statute, either expressly or by necessary implication.

CONDONATION OF IRREGULARITIES

- Irregularities in procedure can be condoned in the following instances:
 1. Where the irregularity has not caused a substantial injustice;
 2. Where the irregularity has caused a substantial injustice but the prejudice to creditors can be remedied by an appropriate court order.
- The courts have also recognised the following additional grounds whereby an irregularity can be condoned:
 1. Where the *de minimus non curat lex* rule is applicable;
 2. Where all interested parties have waived compliance with the provisions of the Act;
 3. Where the provision is not peremptory and has been substantially complied with;
 4. Where it was impossible for the party concerned to comply with the Act.

STUDY UNIT 2 – VOLUNTARY SURRENDER

INTRODUCTION

- There are the following 2 ways in which a debtor's estate can be sequestrated:
 1. Voluntary Surrender – the debtor himself (or his agent) applies to court for acceptance of the surrender of his estate.
 2. Compulsory Sequestration – a creditor or creditors (or his or their agent) apply to court for the sequestration of the debtor's estate.
- The procedure and requirements for each method differ in material aspects, although the consequences of the sequestration order are the same in both instances.

WHO MAY APPLY

- The following persons may apply to surrender the estates mentioned:
 1. Estate of a natural person – the debtor himself or his agent.
 2. Estate of a deceased debtor – the executor.
 3. Estate of a person incapable of managing his own affairs – the *curator bonis*.
 4. Partnership estate – all the members of the partnership who reside in SA, or their agents.
 5. Joint estate of spouses married in community of property – both spouses.

REQUIREMENTS

- The court can only accept the surrender of a debtor's estate if it is satisfied that:
 1. The debtor's estate is in fact insolvent;
 - The total liabilities must exceed the value of all the debtor's assets.

STUDY UNIT 3 cont...

- The Master may specially direct that the applicant have any of the property in the statement of affairs valued by a sworn appraiser or a person designated by the Master for this purpose.
- The Master may also call for an independent valuation.
- In the case of the simultaneous surrender of a partnership estate and the private estate of a partner, a separate statement of affairs for each estate must be prepared.
- The statement of affairs must be lodged in duplicate at the Master's Office in order to lie for inspection.
- If there is no Master's Office, then the statement of affairs must lie for inspection at the Office of the Magistrate's Court in that district.
- The statement of affairs must lie for inspection by creditors at all times during office hours for a period of 14 days.
- On expiry of the inspection period, the Master or Magistrate must issue a certificate confirming that the statement of affairs has lain for inspection and whether creditors lodged any objections.
- The certificate must be filed with the Registrar before the application is heard in Court.

EFFECT OF NOTICE OF SURRENDER

- The publication of a notice of surrender has the following important consequences:

1. Stay of Sales in Execution

- Master may only permit the sale to proceed in cases where the value of the property does not exceed R5000.
- Where the Sheriff proceeds with the sale, it will be regarded as an illegal sale and not enforceable by the buyer of the property, unless the property has already been transferred and the buyer acted *boni fides*.

APPLICATION FOR SURRENDER

- The application for surrender is brought by way of a Notice of Motion supported by affidavit (see attached sample or your textbook on pages 257 to 259).
- The purpose of the founding affidavit is to persuade the Court that the requirements for voluntary surrender have been satisfied.
- See your textbook on pages 23 and 24 for the information that should be contained in the affidavit.
- The Notice of Motion, founding affidavit/s and annexures must be filed with the Registrar of the High Court prior to the date advertised in the Notice of Surrender.
- If the debtor is an employer, he must provide a copy of the application to a "consulting party" in terms of the Labour relations Act (e.g. trade union, workplace forum etc).
- In the Cape, a Master's report must be obtained and filed prior to the set-down of the application.
- A creditor has the right to oppose the application, and must deliver an affidavit/s, prior to the date of the application, setting out the grounds of opposition.
- The debtor may then deliver replying affidavits.
- See page 25 of your textbook for a list of the documents that must be filed in the Court file prior to the application being heard.

COURTS DISCRETION

- See your textbook on page 26 for examples of factors that influence the Court towards refusing an application for surrender.

COSTS OF SURRENDER

- The taxed costs incurred in surrendering the estate are included in the costs of sequestration and are payable out of the estate.

STUDY UNIT 3 – VOLUNTARY SURRENDER CONT...

PRELIMINARY FORMALITIES

1. Notice of Intention to Surrender

- The debtor must publish a notice of surrender in the *Government Gazette* and in a newspaper circulating either where he resides or has his principal place of business.
- The notice must contain the following information:
 1. The full names, address and occupation of the debtor;
 2. The date and place where the application will be made;
 3. When and where the debtor's statement of affairs will lie for inspection.
- Publication must take place not more than 30 days before the date of application and not less than 14 days before the date of application.
- The purpose of the notice of surrender is to alert creditors as to the intended application, in case they should wish to oppose it.
- The newspaper must circulate in the area where the creditors are located, even if the debtor no longer resides or carries on business there.
- Publication of the notices must be proved, by filing copies of cuttings from the newspapers with the court.

2. Notice to Each Creditor

- Within 7 days of the date of publication of the notice of surrender, the debtor must deliver or post a copy of the notice to every one of his creditors whose address he knows or can ascertain.
- The purpose is to provide extra protection to creditors.
- The posting of notices is usually proved by means of an affidavit, by the debtor or his attorney, stating that the notices have been sent.

3. Preparation and Lodging of Statement of Affairs

- The statement of affairs must comprise the following:
 1. A balance sheet;
 2. A list of immovable assets, with estimated value and details of any mortgages on the assets;

STUDY UNIT 4 – COMPULSORY SEQUESTRATION

REQUIREMENTS

- The second way in which a debtor's estate is sequestrated is called compulsory sequestration, whereby a creditor/s make the application for sequestration.
- The Court may grant an application for compulsory sequestration of a debtor's estate if it is satisfied that:
 1. The applicant has established a claim that entitles him to apply for sequestration of the debtor's estate - Section 9(1);
 2. The debtor has committed an act of insolvency or is insolvent;
 3. There is reason to believe that it will be to the advantage of creditors of the debtor if his estate is sequestrated - Section 12(1).
- The *onus* of satisfying the court on these 3 matters rests throughout on the sequestrating creditor, and at no stage is the debtor required to disprove any element.

APPLICANT ENTITLED IN TERMS OF SECTION 9(1)

- The creditor must have a liquidated claim against the debtor of not less than R100, or 2 or more creditors must have a liquidated claim against the debtor of not less than R200.
- Whether or not a creditor holds security for the claim is irrelevant.
- An agent bringing the application on behalf of the creditor must have prior authorisation.
- See your textbook on pages 29 and 30 for the definition and examples of liquidated claims.
- **Liquidated Claim** – a monetary claim capable of speedy and easy proof.

FRIENDLY SEQUESTRATION

- This is an application for the sequestration of the debtor's estate by an amicable creditor.
- The court must be mindful of the fact that there is the potential for collusion and abuse.
- Thus the courts should scrutinize every friendly sequestration with particular care to ensure that the requirements of the Insolvency Act have been complied with and that the creditors are not prejudiced.
- See your textbook on page 40 for the information to be obtained from the debtor in these cases.

- The Court always has discretion when dealing with an application for compulsory sequestration – see Amod v Khan.
- Costs.
- Vexatious proceedings – debtor can claim compensation in these cases.
- Setting aside sequestration order.

STUDY UNIT 6 – LEGAL POSITION OF THE INSOLVENT

CONTRACTS

- The insolvent is not permitted to enter into any contracts dealing with his sequestrated estate.
- Prohibited contracts are voidable by the trustee.
- Non-prohibited contracts are valid and binding.

EARNING A LIVELIHOOD

- Cannot be a trader who is a general dealer or a manufacturer.
- Cannot be in a position of trust (i.e. trustee, director of company; managing director of close corporation, etc).

LOCUS STANDI

- The insolvent can sue and be sued regarding matters that fall outside of the sequestrated estate.
- The insolvent will usually be asked to furnish security for costs.
- The trustee must sue and be sued on behalf of the debtor in those matters that fall within the sequestrated estate.
- Where the trustee refuses to act on behalf of the insolvent regarding a legal matter, the insolvent may then step in and will have locus standi in these matters.

STUDY UNIT 8 – VESTING OF ASSETS OF SOLVENT SPOUSE

- The definition of solvent spouse in terms of the Insolvency Act includes all marriages as well as live-in partners.
- Duty of solvent spouse to lodge statement of affairs within 7 days.
- Property to be released includes the following:
 1. Assets owned before the marriage;
 2. Assets acquired under marriage settlement;
 3. Assets acquired by valid title;
 4. Property protected under law (this provision is now obsolete);
 5. Property acquired with proceeds of the above.
- Onus of proof is on the solvent spouse to prove the property should be released.
- Solvent spouse must file an affidavit in order for the trustee to release the property.
- Master of the High Court to resolve any disputes.

- This is an exception to the general rule that one cannot claim specific performance where the person is insolvent.
- The other party will also have a concurrent claim for any loss suffered as a result of the cancellation.
- Section 35 is only applicable where delivery (i.e. registration) has not been effected.
- This is because the seller is still the owner of the property.
- The property must be immovable property, although it can be substantially immovable (i.e. it can include movables).
- Where the property has already been registered, the seller will only have a concurrent claim, and cannot claim specific performance.

HIRE OF PROPERTY

- Where an insolvent hires either movable or immovable property, the trustee must elect to either uphold or repudiate the contract.
- Where the trustee decides to repudiate the contract, he must give notice of repudiation in writing.
- If no notice is given within 3 months, the contract is deemed to be repudiated.
- **SECTION 37** states that where the contract is repudiated, the trustee loses his right to claim compensation for improvements, unless these were done by agreement with the lessor.
- The lessor further has:
 1. A preferrent claim from date of sequestration.
 2. A secured claim i.r.o immovable property due to tacit hypothec.
 3. A concurrent claim i.r.o any other loss or non-performance of lease.
- Sureties are still liable in terms of their obligations.

STUDY UNIT 10 – UNCOMPLETED CONTRACTS AND LEGAL PROCEEDINGS NOT YET FINALISED

CONTRACTS WHICH ARE SUSPENDED OR TERMINATE ON SEQUESTRATION

- **Employment contract made by the insolvent as employer:**
 - Employee is not obliged to render services, not entitled to salary/wages, and not entitled to any employment benefits.
 - Trustee must consult with all applicable parties (e.g. employees, trade unions, etc) and must submit written proposals within 21 days of appointment.
 - Creditors can participate should they wish to do so.
 - Where the business is sold, the employment contract continues with the new owner on the same terms and conditions as with the insolvent employer.
 - If nothing is done, the employment contract will terminate 45 days after the trustee's appointment.
 - Employees' have a preferrent claim.
- **Contract of mandate:**
 - This is an agreement to either perform a task or render a service.
 - The contract terminates (i.e. comes to an end) if either the principal or the agent becomes insolvent.

CONTRACTS WHICH THE TRUSTEE CANNOT REPUDIATE

- **Lease of immovable property:**
 - This is the case where the landlord / lessor becomes insolvent.
 - The general rule is that the property must be sold subject to the lease.
 - However, the lease may be cancelled if the property is subject to a mortgage bond that was registered prior to the lease.

STUDY UNIT 11 – UNCOMPLETED CONTRACTS AND LEGAL PROCEEDINGS NOT YET FINALISED

PURCHASE OF GOODS IN TERMS OF INSTALMENT SALE TRANSACTION

- The contract must be a contract in respect of corporeal, movable property.
- The purchase price can either be paid in instalments or in a lump sum at a future date.
- Delivery must have occurred but ownership not yet transferred from the seller to the purchaser.
- **SECTION 84** states that in these circumstances, where the purchaser goes insolvent, the seller will lose his right of ownership and ownership will immediately pass to the insolvent.
- However, the seller will have a secured hypothec over the property and may claim the property as security.
- Section 84 is only applicable if there is a valid instalment sale agreement and the trustee is in possession of the property.
- Where the property has already been returned to the seller by the purchaser before he is declared insolvent, the trustee may demand delivery of the movable, subject to the trustee paying the full outstanding balance in terms of the agreement.
- In the case of the seller going insolvent, section 84 is not applicable, and the purchaser is in the very weak position of having the contract cancelled and a concurrent claim against the insolvent seller.

TRANSACTION ON EXCHANGE

- See your textbook page 82 for a discussion on this topic.

AGREEMENT ON INFORMAL MARKET

- See your textbook page 83 for a discussion on this topic.

- The purpose of the meeting is for the trustee to give his report, the creditors to prove their claims, and the creditors to give directions to the trustee regarding winding up of the insolvent estate.

THE SPECIAL MEETING

- Convened by the trustee.
- Notice of the date, time and place of the meeting must be published in the Government Gazette.
- The Master's consent must also be given to hold this meeting.
- The purpose of the meeting is to interrogate the insolvent and for proving creditor's claims.

THE GENERAL MEETING

- Convened by the trustee.
- May also be convened at the request of the Master or creditors representing a fourth of the value of all proved claims.
- Notice of the date, time and place of the meeting must be published in the Government Gazette as well as one or more newspapers circulating in the area (both English and Afrikaans).
- The purpose of the meeting is to give the trustee directions on any matter relating to the winding up of the insolvent's estate.

GENERAL PROVISIONS RELATIN TO MEETINGS

- The meeting are usually held at the Master's office or at the Magistrate's Court.
- The presiding officer is usually the Magistrate.

PERSONS DISQUALIFIED FROM BEING TRUSTEE

- A person may be either absolutely disqualified or relatively disqualified from being trustee of a person's insolvent estate.
 1. Absolute Disqualification – cannot be trustee of anyone's estate.
 - See page 107 of textbook for cases of absolute disqualification.
 2. Relative Disqualification – cannot be trustee of that specific person's estate.
 - See page 107 of textbook for cases of relative disqualification.

VACATION OF OFFICE

- See page 107 of textbook for when a trustee must vacate his office.

company cannot pay its debts (court looks at "contingent and prospective liabilities" of the company.

➤ See example in textbook at the top of page 214.

7) Dissolution of external company

8) Just and equitable

➤ See textbook page 214 and 215 for instances of the above.

• The following parties may apply for the winding up of a company:

1) The company

➤ May be authorised by either the members or the board of directors.

2) One or more creditors

➤ Including contingent or prospective creditors, and the claim need not exceed any particular amount.

3) One or more of its members

➤ Must be registered in the register of members for at least 6 months or have acquired the shares upon death of a former member.

➤ Members may not apply based on one of the following reasons mentioned above:

i. Special resolution

ii. Inability to pay debts

iii. Dissolution of external company

➤ The members have the following options in terms of winding up the company:

i. Members' voluntary winding up by special resolution;

ii. Creditors' voluntary winding up by special resolution;

iii. Compulsory winding up by special resolution on any of the grounds of section 344, except those mentioned above;

- Creditors' voluntary winding up can only take place if the company is unable to pay its debts in full.

CONSEQUENCES OF WINDING UP

- There are the following consequences of a winding up order:
 - 1) Commencement of winding up
 - A winding up by the court commences when the application is first presented to the court (**section 348**), even where the final order is granted on another application.
 - A voluntary winding up commences when the special resolution is registered with the Registrar.
 - 2) Directors divested of powers and control
 - 3) Subsequent unauthorised dispositions void
 - 4) Stay of proceedings
 - 5) Notice of winding up

LIQUIDATOR

- See sections 23.6.1 to 23.6.4 on pages 223 and 224 for provisions relating to liquidators.

IMPEACHABLE TRANSACTIONS

- **Section 340** deals with these transactions and they are identical to the provisions in the Insolvency Act.