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A Comparative Analysis of Creditor-Funded Insolvencies in South Africa

BY

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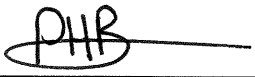
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Chapter 1: Introduction

1.1 Introduction

It is trite that the imposition of creditor liability, in the form of compulsory contributions, has remained the primary means of defraying administrative expenses in estates devoid of sufficient free residue in South Africa. The concept of ‘creditor-funded insolvencies’ emanates from the prescripts of the Insolvency Act 24 of 1936 (“**the Insolvency Act**”), which requires certain creditors to effectively “make good any deficiency” prevailing within an insolvent estate.¹ Sections 89 and 106 of the Insolvency Act formalize this process by apportioning liability amongst the *concursum* in accordance with certain hierarchical and/or circumstantial considerations.² It is common cause that the aforesaid provisions apply *mutatis mutandis* to juristic persons under the ambit of the Companies Act 61 of 1973 (“**the Companies Act**”).³ In essence, this envisages a scenario whereby proven creditors are saddled with the financial burden of discharging the various costs of sequestration, as contemplated in section 97 of the Insolvency Act, whilst deriving no pecuniary benefit therefrom.⁴ This denotes a highly prejudicial state of affairs, whereby creditors are obliged to incur further expenditure to offset the costs of sequestration. Burdette comments on the injurious nature of contributions by asserting that:

*“Kontribusie is seker een van die onregverdigste fasette van ons insolvensiereg deurdat 'n skuldeiser, wat reeds finansiële skade ly vanwee die insolvensie van die boedel van die persoon of instansie wat hom geld skuld, verdere verlies ly deurdat hy die tekort wat by die administrasie van die boedel ontstaan, moet aanvul.”*⁵

Naturally, the risk of contribution has caused a reduction in creditor participation, with fewer

¹ S 106 of the Insolvency Act 24 of 1936 (“**the Insolvency Act**”).

² S 89(1) and 106 (a) – (c) of the Insolvency Act; Smith & Boraine “Crossing Borders into South African Insolvency Law: From the Roman-Dutch Jurists to the UNCITRAL Model Law” 2002 *Am. Bankr. Inst. L. Rev.* 167; S 89(1) of the Insolvency Act pertains to contributions by secured creditors, where the proceeds of a particular asset are insufficient to cover the administrative costs associated therewith. S 106 of the Insolvency Act pertains to contributions where there are deficiencies in the free residue of the estate.

³ S 342(2) read with S 339 of the Companies Act 61 of 1973 (“**the Companies Act**”).

⁴ S 97 of the Insolvency Act.

⁵ Burdette “Kontribusiepligtigheid van Skuldeisers in Insolvente Boedels” 1993 *De Rebus* 1004.

creditors electing to prove their claims.⁶ Diminished creditor involvement has manifested into a universal occurrence characterized by increased “creditor passivity.”⁷ The proclivity of creditors to avoid insolvency proceedings formed part of the World Bank’s *Report on the Treatment of Insolvency on Natural Persons* wherein it commented that “in the overwhelming majority of insolvency cases involving natural persons in the world today, active creditor participation is exceptional.”⁸ The South African Law Commission has further attributed this “lack of interest” to the unlikely prospects of creditors procuring any financial gain from the administrative process.⁹ Moreover, historic records and surveys reveal significant discrepancies between the percentage of creditors receiving dividends and those obliged to contribute towards administrative costs.¹⁰ In particular, the South African Law Commission, in its survey of the Pretoria Master’s Office, discovered that “in 40,6% of the cases creditors were required to pay a contribution.”¹¹ This disconcerting statistic corroborates the materialization of creditor-funded insolvencies in South Africa.

1.2 South Africa’s Pro-Creditor Disposition

The perpetuation of a contribution-orientated construct, through the ambit of the Insolvency Act, may contradict or even defeat the purpose of existing insolvency protocols which are designed *inter alia* to ensure a favorable distribution of proceeds amongst creditors.¹² Such notion has been repeatedly endorsed by South African courts which, to a large extent, espouse a “pro-creditor” disposition.¹³ This was reaffirmed in the recent judgment of *Seevnarayan v Ramjathan* wherein Meyer J reaffirmed the position that “the main object of

⁶ The South African Law Commission *Discussion Paper 86 Project 63* 'Review of the Law of Insolvency (1999) Volume 1 (“**Discussion Paper 86**”).

⁷ Working Group on the Treatment of the Insolvency of Natural Persons, *Report on the Treatment of the Insolvency of Natural Persons* Insolvency and Creditor/Debtor Regimes Task Force, World Bank 2012 available at: <https://documents1.worldbank.org/curated/en/120771468153857674/pdf/ACS68180WP0P120Box0382094B00PUBLIC0.pdf> (last viewed 25 March 2023) (“**World Bank Report**”).

⁸ World Bank Report (2012) 70.

⁹ *Discussion Paper 86* (1999) 6.

¹⁰ *Discussion Paper 86* (1999) 6; Boraine & Roestoff “Fresh start procedures for consumer debtors in South African bankruptcy law” 2002 *Int. Insolv. Rev.* 7.

¹¹ *Discussion Paper 86* (1999) 6.

¹² Evans “Waiving of rights to property in insolvent estates and advantage to creditors in sequestration proceedings in South Africa” 2018 *De Jure* 300.

¹³ Boraine *et al* “The Pro-Creditor Approach in South African Insolvency Law and the Possible Impact of the Constitution” 2015 *NIBLeJ* 61.

insolvency proceedings is to benefit creditors, not one creditor or some creditors, but the general body of creditors.”¹⁴ In light of the foregoing position, it seems perplexing that a contributory model has persisted within South Africa’s insolvency framework without any substantial deviation or variation therefrom. Moreover, the legislature has sought to entrench the *status quo* through the 2015 Draft Insolvency Bill (“**the Bill**”).¹⁵ Whilst it can be conceded that such measures constitute a proverbial ‘last resort’, the apparent recurrence of such phenomenon is irrefutable.

1.3 Statutory Prevention: The Advantage to Creditors Requirement

Without derogating from the adverse connotations of a contributory system, it is evident that the Insolvency Act does make provision for some preventative requirements directed at alleviating the necessity of creditor contributions. The most eminent, and somewhat controversial, of these provisions is the advantage to creditor requirement, which dictates that a commercial benefit must accrue to creditors in order for liquidation or sequestration proceedings to be initiated.¹⁶ The court in *Meskin & Co v Friedman* outlined the meaning of this principle by stating that there must be “a reasonable prospect...that some pecuniary benefit will result to creditors.”¹⁷ Calitz affirms the integral role that such doctrine plays in limiting creditor liability, by expressing that “the rationale behind the “advantage to creditors” requirement in South African insolvency law is *inter alia* that the administration costs are paid out of the estate.”¹⁸ Despite the aforesaid, the overall effectiveness of this requirement remains problematic. Borraine and Roestoff emphasize such ineffectuality by noting that “as far as creditors’ interests are concerned, the efficiency of the advantage to creditors requirement may be questioned.”¹⁹ In addition, the advantage requirement has been severely criticized for its exclusionary nature, in that debtors are precluded from initiating sequestration proceedings if they are unable to prove that a benefit or advantage will accrue

¹⁴ *Seevnarayan v Ramjathan* 2021 ZAGPJHC 46.

¹⁵ Working Document of the Department of Justice regarding new insolvency legislation: Draft Insolvency Bill of 2015 and Explanatory Memorandum (“**the Bill**”).

¹⁶ See Ss 6(1), 10(c) and 12(1)(c) of the Insolvency Act.

¹⁷ *Meskin & Co v Friedman* 1948 (2) SA 555 (W).

¹⁸ Calitz “Developments in the United States Bankruptcy Law: A South African Perspective” 2007 *Obiter* 410.

¹⁹ Borraine & Roestoff 2002 *Int. Insolv. Rev.* 7.

to their creditors.²⁰ This has led to a phenomenon where debtors are effectively “too poor to go bankrupt”, in that they possess insufficient disposable income or assets to initiate the formal insolvency procedure.²¹

1.4 Pre-emptive Measures: Reporting Standards

The Insolvency Act further provides various reporting standards directed at informing creditors of the inherent affairs and condition of the estate. This is evident in section 81 of the Insolvency Act which confers a positive duty on the trustee to “submit a full written report” to the creditors of a natural person subject to sequestration proceedings.²² The written report must include *inter alia* the assets, liabilities and various contraventions, if any, in the estate.²³ Section 402 of the Companies Act provides a similar duty on the liquidator of a juristic person that is subject to liquidation or winding-up proceedings.²⁴ These reporting prerequisites offer, albeit indirectly, a pre-emptive instrument for creditors to assess the viability of proving their claims. These provisions, however, do not prescribe a duty on the trustees and liquidators to voice any inherent threat or risk of contribution to creditors and same must be deduced from the information contained in the report. Interestingly, the Bill seeks to remedy such omission through the introduction of section 42(2)(b) which, if implemented, will require liquidators to express an opinion as to whether “there is a risk of a contribution by creditors in terms of section 99.”²⁵ This is an unequivocal attempt by the legislature to mitigate the risk of creditor contributions and the detrimental financial implications associated therewith. Notwithstanding such endeavors, the proliferation of creditor-funded insolvencies remains an imminent threat to South Africa’s insolvency framework. This may necessitate the reformation of contemporary insolvency policies and protocols to incorporate additional preventative measures devised at limiting creditor liability.

²⁰ Coetzee & Roestoff “Consumer debt relief in South-Africa – Should the insolvency system provide for NINA debtors? Lessons from New Zealand” 2013 *Int. Insolv. Rev.* 2.

²¹ Rochelle “Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth: the American Experience, and Possible Uses for South Africa” 1996 *TSAR* 315.

²² S 81(1) of the Insolvency Act.

²³ S 81(1) of the Insolvency Act.

²⁴ S 402 of the Companies Act.

²⁵ S 42(2)(b) of the Bill.

1.5 Purpose and Methodology: Re-evaluating Creditor Liability

It should be stressed that the current discourse does not intend to propagate an exclusively pro-creditor orientation nor does it propose that creditor liability, in the form of creditor contributions, should be abolished in its entirety. On the contrary, it seeks to ascertain whether South Africa's insolvency law makes adequate provision for the circumvention of creditor-funded insolvencies. In addition, it scrutinizes alternative means of limiting the detrimental financial burden incumbent on creditors. In so doing, it adopts a holistic approach whereby domestic legislation is discussed in conjunction with international policy considerations. Despite advocating for the mitigation of creditor liability, the interests of debtors must not be disregarded. In considering the topic of insolvency reformation, it is imperative that insolvency proceedings achieve a reasonable balance, whereby creditors derive sufficient benefit and debtors are extended the requisite reprieve through *inter alia* the discharge of pre-sequestration debt.²⁶ In amplification, the South African Law Commission has noted the importance of achieving an equilibrium between debtor and creditor interests through the implementation of a mutually beneficial construct.²⁷ This is evidenced by the following statement:

"A balance must be struck between the rights of creditors and giving a debtor an opportunity to make a fresh start. It is, however, expected from debtors to act honestly and assist in the winding up of their insolvent estates." (emphasis added)²⁸

The comparative component of this study analyzes the manner in which different insolvency regimes fund deficiencies in assetless estates, with particular emphasis on the defrayment of administrative expenses. The German Insolvency Code (*Insolvenzordnung*) and the United Kingdom's Insolvency Act of 1986 ("**UK Insolvency Act**") advance alternative methods of discharging the costs of insolvency proceedings without directly implicating the *concursum*.²⁹ These include *inter alia* the deferral of costs, the implementation of minimum asset requirements and the discontinuation of insolvency proceedings due to insufficient

²⁶ Boraine & Roestoff 2002 *Int. Insolv. Rev.* 9-10.

²⁷ *Discussion Paper 86* (1999) 9.

²⁸ *Discussion Paper 86* (1999) 9.

²⁹ German Insolvency Code (*Insolvenzordnung*) of 1994 ("**German Insolvency Code**"); the United Kingdom's Insolvency Act of 1986 ("**the UK Insolvency Act**").

assets.³⁰ In addition, the restructuring of hierarchal considerations in conjunction with judicial discretion may assist in alleviating the necessity of formal creditor contributions.³¹ Section 156 of the UK Insolvency Act provides that “The court may, in the event of the assets being insufficient to satisfy the liabilities, make an order as to the payment out of the assets of the expenses incurred in the winding up in such order of priority as the court thinks just.”³² The foregoing Eurocentric systems must be construed with appropriate cognizance of South Africa’s socio-economic dispensation.

1.6 Research Questions: Dissecting a Contributory System

The present discourse will endeavor to address certain contentious issues regarding South Africa’s contributory system in insolvency law. The principal question being how creditor-funded insolvencies in South Africa can be circumvented and/or avoided. Some of the ancillary queries include, *inter alia*, whether there is a need to supplement and/or reform South Africa’s contemporary insolvency legislation to prevent creditor-funded insolvencies; whether the Insolvency Act and accompanying legislative instruments make adequate provision for the protection of creditors’ interests and the avoidance of creditor liability; the specific financial implications occasioned by sections 89(1) and 106 of the Insolvency Act; whether there are alternative methods of defraying administrative costs in estates devoid of sufficient assets; identifying the relevant stakeholders to assume the financial obligation of funding assetless insolvencies; whether the bankruptcy policies of Germany and United Kingdom (“**UK**”) offer sufficient reprieve to creditors; and whether such foreign policies find appropriate application within South Africa’s distinct socio-economic dispensation. The aforesaid list is not exhaustive and additional queries will be raised and addressed throughout the study.

1.7 Delineation and Limitation: The Circumvention of Creditor-Funded Insolvencies

The primary point of departure herein will be to critically examine the South African insolvency framework, insofar as it instils the notion of creditor-funded insolvencies. Such

³⁰ Ss 4a, 26, 207 of the German Insolvency Code.

³¹ S 156 of the UK Insolvency Act.

³² S 156 of the UK Insolvency Act.

term must be construed as a direct reference to statutorily enforced creditor contributions, which emanate from the Insolvency Act. The study will restrict itself to the specific statutory provisions and/or prerequisites that give effect to creditor liability, or the prevention thereof, together with the circumstances surrounding the imposition of contributions. The comparative component will be confined to a Eurocentric domain, whereby the insolvency regimes of Germany and the UK will be assessed. The discourse will further address how such Eurocentric policies and/or measures can be implemented in a manner that promotes both creditor and debtor interests.

1.8 Overview of Chapters: Domestic and International Considerations

The structure of the current study dictates that a logical progression be followed in order to understand the origin of South Africa's contributory framework. Accordingly, chapter 2 will focus on the South African insolvency perspective with specific emphasis on sections 89 and 106 of the Insolvency Act.³³ This chapter will provide an in-depth analysis of the specific circumstances warranting contributions by creditors, the specific administrative expenses as contemplated in section 97 of the Insolvency Act and the various preventative measures employed by the legislature to counter and/or limit creditor liability.³⁴ It will further clarify the proposed amendments introduced by the Bill and the impact of such changes on the obligation of creditors to remedy or "make good deficiencies" in insolvent estates.³⁵ Chapter 3 will introduce the comparative element, whereby the bankruptcy policies of Germany and the UK will be construed in order to ascertain how such systems approach the defrayment of administrative expenses, where there is an apparent shortfall in estates. In particular, the discharge and deferment protocols employed in the German Insolvency Code and the judicial restructuring of administrative costs, in terms of the UK Insolvency Act, will be duly considered as potential alternatives to South Africa's current framework.³⁶ The final chapter will collate the findings of the comparative analysis and deliberate on the possible supplementation or reformation of South Africa's insolvency laws to better prevent and/or

³³ S 106 of the Insolvency Act.

³⁴ S 97 of the Insolvency Act.

³⁵ S 106 of the Insolvency Act.

³⁶ See notes 30 and 31 above regarding the relevant provisions of the German Insolvency Code and the UK Insolvency Act.

mitigate against creditor contributions. This chapter will provide various recommendations on how foreign policy has the potential to assist in the alleviation of adverse contributory policies in South Africa.

Chapter 2: Contributions towards Administration Costs within the South Africa Insolvency Framework

2.1 Introduction

The notion of creditor-funded insolvencies is predicated on the imposition of creditor liability in the form of statutorily-enforced contributions. The obligation to contribute is dependent on various factors pertaining to the proof, classification and/or formation of a creditor's claim.³⁷ Such obligation is derived from sections 89 and 106 of the Insolvency Act, which inflict a financial duty on creditors to contribute towards deficiencies prevailing within either the encumbered or free residue accounts.³⁸ Before dealing with such provisions *infra*, one must first distinguish between the varying applications associated with each section. Section 89 pertains to deficits in the encumbered asset account, whereby the proceeds are insufficient to discharge the costs incurred in the realization, maintenance or preservation of secured assets.³⁹ In contrast, section 106 concerns shortfalls prevailing in the free residue account, in instances where the funds are inadequate to satisfy the sequestration costs prescribed in section 97.⁴⁰ The aforesaid constitutes the foundational elements of South Africa's contributory framework, from which the concept of creditor-funded insolvencies has effectively emerged. In the premise, it is necessary to adduce a brief exposition on each of these respective sections, together with ancillary sections related thereto, in order to ascertain how such provisions perpetuate creditor liability within the broader socio-economic context. In doing so, it is necessary to differentiate between voluntary and compulsory sequestration proceedings and the varying degrees of liability imputed on the *concursum* as a result thereof.⁴¹ Importantly, the mitigation of creditor contributions must also be scrutinized in light of existing protocols and/or prerequisites envisaged in the Insolvency Act. Such considerations must further be construed in conjunction with the measures proffered in

³⁷ Bertelsman *et al Mars: The Law of Insolvency in South Africa* (2019) 423.

³⁸ Ss 89 and 106 of the Insolvency Act.

³⁹ S 89 of the Insolvency Act; Bertelsman *et al* (2019) 544; Burdette 1993 *De Rebus* 1008; Evans "Insolvency: The Costs to Which Securities are Subject, and the Utilisation of Section 89(2) of the Insolvency Act by Secured Creditors" 1995 *S. Afr. Mercantile L.J.* 86.

⁴⁰ S 106 of the Insolvency Act; Bertelsman (2019) 558; Burdette 1993 *De Rebus* 1004; Evans 1995 *S. Afr. Mercantile L.J.* 86.

⁴¹ Burdette 1993 *De Rebus* 1004.

the Bill and the intrinsic ramifications that these would have on reducing the liability of creditors to contribute.⁴²

2.2 The Emergence of a Contributory Framework

2.2.1 Contributions in terms of Section 89(1) of the Insolvency Act

Shortfalls in the encumbered asset account of an insolvent estate necessitate the levying of a contribution from creditors who hold security over a particular asset.⁴³ Section 2 of the Insolvency Act defines 'security' as relating to the specific property "over which the creditor has a preferent right by virtue of any special mortgage, landlord's legal hypothec, pledge or right of retention."⁴⁴ Section 89(1) of the Insolvency Act specifies the costs incurred in the realization, maintenance and conservation of secured assets.⁴⁵ These costs pertain, *inter alia*, to the remuneration and/or compensation of the trustee/liquidator, the fees of the Master of the High Court ("**the Master**") and the various charges, taxes and premiums associated with the repair, protection and security of the asset.⁴⁶ Although necessary, the incurrence of these expenses presents a precarious situation in the event of the proceeds, derived from the realization of a secured asset, being insufficient to cover the costs.⁴⁷ In order to rectify the deficit, a contribution is exacted from the proven secured creditors "who would have been entitled in priority to other persons to payment if the proceeds had been sufficient to cover the costs."⁴⁸ Interestingly, the court in *Standard Bank of South Africa v Townsend* held that the costs of realization are incapable of being reclaimed from the estate.⁴⁹ Heher J reasoned, in this regard, that "this is apparently a disadvantage which the Legislature considered appropriate that a creditor should bear in order to obtain the benefit of a preferent claim."⁵⁰ Section 89(1) of the Insolvency Act thus inflicts an onerous burden on secured creditors where the proceeds of an encumbered

42 The Bill.

43 Bertelsman *et al* (2019) 544; Burdette 1993 *De Rebus* 1008.

44 S 2 of the Insolvency Act.

45 S 89(1) of the Insolvency Act.

46 S 89(1) of the Insolvency Act; Bertelsman *et al* (2019) 544.

47 Bertelsman *et al* (2019) 544; Evans 1995 *S. Afr. Mercantile L.J.* 84.

48 S 89(1) of the Insolvency Act.

49 *Standard Bank of South Africa Ltd v Townsend* 1997 (3) SA 41 (W); Bertelsman *et al* (2019) 544.

50 *Standard Bank of South Africa Ltd v Townsend* 1997 *supra* at 58.

asset fail to sufficiently offset the realization and preservation costs. Moreover, secured creditors are unable to reclaim such costs from the estate, leaving them in a financial quandary with little to no recourse.

2.2.2 *Mitigating Concurrent Exposure: Section 89(2) of the Insolvency Act*

Notwithstanding the foregoing, section 89(2) does enable secured creditors to mitigate their exposure, in terms of the concurrent portion of their claim, by relying solely on the proceeds of their security.⁵¹ From the outset, it should be noted that this provision does not exonerate secured creditors from all liability, nor does it eliminate the threat of contribution in its entirety. Instead, it affords secured creditors the option of reducing their risk by dissociating themselves from the free residue of the insolvent estate.⁵² In order to invoke this provision, secured creditors must stipulate, by way of affidavit, that they rely exclusively on the proceeds of the property constituting their security.⁵³ In *Bank of Lisbon & South Africa Ltd v The Master & Others*, the court conceded that a creditor that relies on his security “escapes liability to contribute as a concurrent creditor.”⁵⁴ Whilst this does proffer an attractive ‘escape’ mechanism for creditors, it does have the concomitant effect of limiting the amount a creditor is entitled to recover.⁵⁵ In this respect, if the proceeds fail to satisfy the creditor’s claim in full, the creditor will be unable to recover the remainder of his claim from the free residue of the insolvent estate.⁵⁶ Secured creditors must therefore determine whether the prospects of recovering the full quantum of their claim outweighs the danger of having to contribute.⁵⁷ This presents a proverbial ‘no-risk no-reward’ scenario, where secured creditors may either mitigate their potential liability, by relying on

⁵¹ S 89(2) of the Insolvency Act; Bertelsman *et al* (2019) 560; Roestoff & Joubert “Liability of a Body Corporate as Applicant Creditor to Contribute towards the Cost of Sequestration - First Rand Bank Ltd v Master of the High Court (Pretoria) (53071/2016) [2018] ZAGPPHC 806 (18 April 2018)” 2019 *THRHR* 644.

⁵² Evans 1995 *S. Afr. Mercantile L.J.* 87.

⁵³ Roestoff & Joubert 2019 *THRHR* 644; Evans 1995 *S. Afr. Mercantile L.J.* 84.

⁵⁴ *Bank of Lisbon & South Africa Ltd v The Master & Others* 1987 (1) SA 276 (A) at 279.

⁵⁵ Smith “Late Proof of a Claim in Insolvency, to Avoid the Risk of Liability to Contribute to Sequestration Costs” 1999 *S. Afr. Mercantile L.J.* 104.

⁵⁶ Burdette “Contribution by Creditors in Insolvent Estates - has section 89(2) of the Insolvency Act become Obsolete? Snyman V the Master 2003 1 SA 239 (T)” 2003 *THRHR* 525.

⁵⁷ Evans 1995 *S. Afr. Mercantile L.J.* 87.

the proceeds of their security, or assume the inherent risk associated with partaking in the free residue. Evans encapsulates this by noting the following:

“The creditor must elect, when proving his claim, whether he will, by electing also to share in any free residue, expose himself to the danger of becoming a contributor, or whether he would rather avoid such consequences by relying solely for the satisfaction of his claim on the proceeds of the property which constitutes his security.”⁵⁸

It may therefore be prudent for secured creditors to forgo the concurrent portion of their claims in order to avoid contribution all together. However, section 89(2) was not designed to relinquish the concurrent portion of a creditor’s claim.⁵⁹ This was reaffirmed in *Absa Bank Ltd v The Master & Others NNO*, where Marnewick AJ commented that “the immunity allowed by s 89(2) of the Act was not intended to be a *quid pro quo* for the abandonment of that part of the claim which exceeds the value of the security held by the creditor concerned.”⁶⁰ In amplification, the court reasoned that the intrinsic purpose of this provision was rather to alleviate the contributory burden, foisted on secured creditors, by apportioning liability amongst those creditors for whom additional expense was being incurred (i.e. the concurrent creditors).⁶¹ Despite this, it is undeniable that by abandoning or discarding the concurrent portion of their claims, secured creditors can reduce their risk of contribution. This provision can accordingly be regarded as an effective instrument for circumventing contribution.

2.2.3 *The Conditional Implementation of Section 89(2) and the Deferment of Proof*

Despite being highly advantageous, section 89 (2) of the Insolvency Act has been subject to extensive scrutiny regarding its interpretation and the conditional manner in which it is implemented.⁶² As an example, it has become a common industry practice for secured creditors to assert in their claims that they rely on the proceeds of their security only in circumstances where there is an imminent threat of contribution.⁶³ Accordingly, the

⁵⁸ Evans 1995 S. Afr. Mercantile L.J. 87.

⁵⁹ Smith 1999 S. Afr. Mercantile L.J. 101.

⁶⁰ *Absa Bank Ltd v The Master & Others NNO* 1998 (4) SA 15 (N).

⁶¹ *Absa Bank Ltd v The Master & Others NNO supra* at 24.

⁶² Evans 1995 S. Afr. Mercantile L.J. 87.

⁶³ Evans 1995 S. Afr. Mercantile L.J. 87.

benefit envisaged in section 89(2) is made conditional upon the occurrence of a future uncertain event.⁶⁴ This has been openly criticized by several commentators, such as Evans, who disapprove of the “uncertainty” and apparent prejudice occasioned by such practice.⁶⁵ In order to dissuade secured creditors from employing these contingency clauses, Evans proposes that secured creditors prove their claims at a later stage.⁶⁶ By doing so, Evans submits that creditors will be better equipped to assess the feasibility of proving their claims which, in turn, will diminish their risk of having to contribute.⁶⁷ In the matter of *Cools v The Master*, Prisman AJ adopted a similar line of reasoning by stating that:

“A creditor would therefore be justified in withholding his claim from proof until he is satisfied that, in his opinion, it is worthwhile running the risk of becoming liable for a contribution in terms of the Act” (emphasis added).⁶⁸

2.2.4 Late Proof of Claims in terms of Section 104 of the Insolvency Act

In delaying the proving of their claims, secured creditors must have due regard to the provisions of section 104 of the Insolvency Act.⁶⁹ In essence, this section permits creditors to prove their claims, pursuant to the trustee lodging a plan of distribution with the Master, upon demonstrating that he “has a reasonable excuse for the delay in proving his claim.”⁷⁰ Should the Master be content with the excuse provided, the creditor will be entitled to share in the distribution of the estate.⁷¹ The discretionary function assumed by the Master could therefore hamper a creditor’s ability to prove his claim at a later stage. However, presuming that a valid excuse is indeed presented, a creditor will be permitted the requisite deferral. Smith, in referring to the dictum of Prisman AJ, argues that the convening of special meetings of creditors, for the late proof of claims, should be deferred if the creditors have “a genuine fear of the risk of contribution.”⁷² Although creditors bear

⁶⁴ Evans 1995 S. Afr. Mercantile L.J. 87.

⁶⁵ Evans 1995 S. Afr. Mercantile L.J. 89.

⁶⁶ Evans 1995 S. Afr. Mercantile L.J. 89.

⁶⁷ Evans 1995 S. Afr. Mercantile L.J. 89.

⁶⁸ *Cools v The Master & Others* 1998 (4) SA 212 (C) at 211J; Smith 1999 S. Afr. Mercantile L.J. 107.
⁶⁹ S 104 of the Insolvency Act.

⁷⁰ S 104(1) of the Insolvency Act; Smith 1999 S. Afr. Mercantile L.J. 107; Bertelsman *et al* (2019) 437.

⁷¹ S 104(1) of the Insolvency Act; Bertelsman *et al* (2019) 437.

⁷² Smith 1999 S. Afr. Mercantile L.J. 108; *Cools v The Master & Others*.

the costs of convening special meetings, in terms of section 42 of the Insolvency Act, it is submitted that these costs are negligible in the circumstances.⁷³ The deferral of creditors' claims, for proof at special meetings, thus constitutes a viable option for alleviating a creditor's obligation to contribute.

2.2.5 The Role of the Trustee/Liquidator in the Prevention of Section 89 Contributions

A question that becomes clearly apposite, in relation to section 89 contributions, is whether the trustee or liquidator ought to have foreseen the incurrence of significant preservation and realization costs upon taking charge of the particular asset. It is common cause that trustees and liquidators bear fiduciary obligations "to recover and reduce into possession all the assets and property of the company [and/or insolvent], to realise them and apply the proceeds in satisfaction of the costs of winding-up [and/or sequestration]."⁷⁴ In performing these duties, it may be more pragmatic for trustees to first embark on a critical analysis and/or evaluation of the asset's value in relation to the projected preservation and realization costs associated therewith. By conducting such an exercise, trustees could advise secured creditors on the appropriate method of disposing or realizing their security, thereby maximizing the proceeds derived whilst simultaneously reducing the costs. This would, in turn, minimize the risk of contribution.

In particular, the rendering of a preliminary assessment by the trustee could influence the implementation of existing realization protocols as envisaged in sections 80*bis*, 82 and 83 of the Insolvency Act.⁷⁵ For instance, where a trustee's investigations reveal that the costs of preserving an encumbered asset could potentially surpass its anticipated return, such trustee could either approach the Master for the requisite permission to dispose of the asset, prior to the second meeting of creditors, or allow the creditor to dispose of the asset himself.⁷⁶ This would facilitate an expedient realization process, resulting in a more favorable return to creditors. Although section 81 of the Insolvency Act does require the

⁷³ S 42 of the Insolvency Act.

⁷⁴ S 391 of the Companies Act.

⁷⁵ Ss 80*bis*, 82 and 83 of the Insolvency Act.

⁷⁶ See s 80*bis*, which relates to the sale of movable or immovable property with the express authorization of the Master. See further s 83(2) which relates to the realization of securities by the creditor himself, if such security is a bill of exchange or financial document, and subject to the creditor giving adequate notice as prescribed therein.

trustees to submit a written report detailing, *inter alia*, the assets and liabilities in the insolvent estate, there is no express duty on the trustee to report or venture an opinion on the projected costs of preserving, maintaining or realizing a particular asset.⁷⁷ It would therefore be beneficial for such obligation to form part of the existing reporting requirements prescribed in section 81 of the Insolvency Act. This would constitute an additional preventative measure aimed at expediting the realization of secured assets in order to decrease exorbitant preservation costs. It would also serve to advise secured creditors of the projected expenses associated with their security, thus assisting them to make an informed decision on whether or not to prove their claims.

2.2.6 Contributions in terms of Section 106 of the Insolvency Act

Where insolvent estates are devoid of free residue or lack sufficient proceeds to discharge the costs of sequestration, it is incumbent upon the proven concurrent creditors to remedy the deficits existing therein.⁷⁸ Liability is therefore apportioned amongst the creditors according to the ranking of their claims in the insolvent estate.⁷⁹ The court in *FirstRand Bank Limited v the Master & Others*, described this section as being a “mechanism for determining which creditors must make a contribution towards the costs of sequestration, when there is no free residue or it is insufficient.”⁸⁰ The wording of section 106 categorically lists the circumstances in which certain classes of creditors will be obliged to contribute.⁸¹ Section 106 thus forms an integral component in the establishment and enforcement of creditor liability. The extent of such liability is dependent on the specific insolvency proceedings which are instituted, being either compulsory sequestration or voluntary surrender.⁸² The former is an entirely creditor-driven process whilst the latter emanates from the insolvent’s own volition.⁸³ These principles apply equally to juristic

⁷⁷ S 81(1)(a) of the Insolvency Act.

⁷⁸ S 106 of the Insolvency Act.

⁷⁹ Burdette 1993 *De Rebus* 1005.

⁸⁰ *FirstRand Bank Limited v Master of the High Court (Pretoria) and Others* (Case no 1120/19) 2021 (4) SA 115 (SCA) at 22.

⁸¹ S 106(a) – (c) of the Insolvency Act.

⁸² Burdette 1993 *De Rebus* 1004.

⁸³ Burdette 1993 *De Rebus* 1005 – 1007.

persons.⁸⁴ The primary difference between compulsory and voluntary proceedings, insofar as contribution is concerned, is the presence or absence of a petitioning creditor.⁸⁵ In terms of compulsory sequestration, a petitioning creditor will assume an automatic or mandatory contributory obligation, whether or not he has elected to prove a claim.⁸⁶ However, owing to the self-instigation of voluntary surrender proceedings, liability cannot be imputed on one particular creditor. Simply put, there is no sequestrating creditor from whom a contribution can be demanded.⁸⁷ In view of the aforesaid, it is apposite to differentiate between these processes to ascertain the overt implications they have on different categories of creditors.

2.2.7 *Compulsory Sequestration and Voluntary Surrender*

Section 9 of the Insolvency Act lays the foundation for the commencement of compulsory sequestration proceedings.⁸⁸ This section prescribes the form and manner in which creditors can petition for the sequestration of a debtor's estate. Importantly, the creditor instigating these proceedings, known as the petitioning creditor, must first demonstrate that he has complied with the necessary procedural formalities, such as setting out the full particulars of his claim, furnishing security to the Master and serving the petition on all persons, entities, and/or organizations listed therein.⁸⁹ Notably, the requirement of "sufficient security", as envisaged in section 9(3)(b), is aimed at offsetting the sequestration costs incurred prior to the appointment of a provisional trustee.⁹⁰ Accordingly, this will only account for a small portion of the sequestration costs. In considering such petition, a court will exercise a discretionary power in ascertaining whether certain *prima facie* requirements have been adequately dispensed with.⁹¹ Of particular importance is section 10(c) of the Insolvency Act, which refers to the notorious

⁸⁴ See in this regard S 339 of the Companies Act, which confirms that the laws of insolvency are to be applied *mutatis mutandis* to the winding of companies that are unable to pay its debts.

⁸⁵ Burdette 1993 *De Rebus* 1005; Burdette "New Problems relating to Contribution in Insolvent Estates" 2000 *THRHR* 462; Evans 1995 *S. Afr. Mercantile L.J.* 86.

⁸⁶ S 14(3) of the Insolvency Act; Burdette 1993 *De Rebus* 1006.

⁸⁷ Evans 1995 *S. Afr. Mercantile L.J.* 86.

⁸⁸ S 9 of the Insolvency Act; Burdette 1993 *De Rebus* 1005.

⁸⁹ See the various formalities contained in S 9 of the Insolvency Act.

⁹⁰ S 9(3)(b) of the Insolvency Act.

⁹¹ S 10 of the Insolvency Act; Roestoff & Boraine "Body Corporate Palm Lane v Mainge: discretion and powers of the court in applications for sequestration" 2013 *De Jure* 209.

advantage to creditors requirement.⁹² In terms thereof, it must be proven that there is a “reason to believe” that a benefit will accrue to creditors.⁹³ The court in *Afrika Amina Engineering CC v Magabe and another* held that the term ‘advantage’ should be interpreted broadly.⁹⁴ Although, this provision relates to a provisional sequestration order, the same onus will be employed in the granting of a final order.⁹⁵ It should also be noted that section 346 of the Companies Act contains a similar procedure in respect of the compulsory liquidation of juristic persons.⁹⁶

In the alternative, a debtor may invoke sequestration proceedings by voluntarily surrendering his estate. This procedure is governed by sections 3 and 4 of the Insolvency Act and, like compulsory sequestration, requires compliance with certain statutory formalities.⁹⁷ These include, *inter alia*, the publication of the surrender, the lodgment of a statement of affairs with the Master and service of the application on various entities and/or persons.⁹⁸ Similarly, an advantage to creditors must be demonstrated to the court.⁹⁹ Interestingly, this requirement is more stringent, in cases of voluntary surrender, as it necessitates a definite benefit and/or advantage to creditors.¹⁰⁰ This differs from the prospective or potential benefit envisaged in compulsory sequestration proceedings. As mentioned above, the primary distinguishing factor between these two processes is the presence or absence of a petitioning creditor. Where such creditor is present, he bears an automatic liability to contribute in terms of section 14 of the Insolvency Act, irrespective of whether or not he participates in the administration process by proving a claim.¹⁰¹ Before consulting this provision, one must first consider the advantage to creditors

⁹² S 10(c) of the Insolvency Act; Roestoff & Boraine 2013 *De Jure* 209.

⁹³ S 10(c) of the Insolvency Act; Roestoff & Boraine 2013 *De Jure* 209.

⁹⁴ *Afrika Amina Engineering CC v Magabe and another (09248/2020) [2023] ZAGPJHC 572 (25 May 2023)* at 44.

⁹⁵ S 12(1)(c) of the Insolvency Act; Roestoff & Boraine 2013 *De Jure* 210.

⁹⁶ S 346 of the Companies Act.

⁹⁷ Ss 3 & 4 of the Insolvency Act.

⁹⁸ See the various formalities contained in ss 3 & 4 of the Insolvency Act.

⁹⁹ S 6(1) of the Insolvency Act.

¹⁰⁰ S 6(1) of the Insolvency Act; Roestoff & Boraine 2013 *De Jure* 211.

¹⁰¹ S 14(3) of the Insolvency Act; Burdette 1993 *De Rebus* 1006; Roestoff & Joubert 2019 *THRHR* 644.

requirement and how liability is apportioned amongst the *concursum*, in relation to the specific criteria set out in section 106 of the Insolvency Act.

2.2.8 *The Advantage to Creditors Requirement*

Despite being highly contentious, due to its exclusionary nature and stringent application, the advantage to creditors requirement remains an integral component in the mitigation of creditor liability.¹⁰² As illustrated in *Meskin supra*, the concept of advantage to creditors requires there to be a “reasonable prospect” of a pecuniary benefit accruing to the general body of creditors.¹⁰³ The court in *Trust Wholesalers and Woolens (Pty) Limited v Mackan* expounded on this, by indicating that the benefit must be conferred on a “substantial portion of the creditors” in accordance with the value ascribed to their respective claims.¹⁰⁴ The significance of this requirement, for purposes of pursuing and successfully initiating sequestration proceedings, has been concisely surmised by Borraine and Roestoff, who note the following: “Proof of the advantage to creditors requirement is of paramount importance and a sequestration order cannot be granted unless the advantage to creditors requirement has been satisfied” (emphasis added).¹⁰⁵ The resultant effect is that sequestration proceedings cannot, theoretically, be instituted unless the requisite advantage has been proven. This should ultimately prevent ‘cashless’ sequestrations from taking place, which will effectively inhibit the need for creditors to contribute.

Notwithstanding certain dissimilarities, the advantage to creditors requirement, finds parallel application in both compulsory and voluntary sequestration proceedings.¹⁰⁶ The first manifestation of the advantage to creditors requirement is observed in section 6(1) of the Insolvency Act which relates to the voluntary surrender of an insolvent’s estate.¹⁰⁷

¹⁰² Borraine & Roestoff “Revisiting the State of Consumer Insolvency in South Africa after Twenty Years: The Courts’ Approach, International Guidelines and an Appeal for Urgent Law Reform” 2014 *THRHR* 351.

¹⁰³ *Meskin v Friedman supra* at 558 – 559.

¹⁰⁴ *Trust Wholesalers and Woolens (Pty) Limited v Mackan* 1958 (2) SA 109 (N); Singini *The Advantage to Creditors Requirement under the Insolvency Act 24 of 1936* (LLM Thesis UP 2020) 11.

¹⁰⁵ Roestoff & Borraine 2013 *De Jure* 208.

¹⁰⁶ Borraine & Roestoff 2002 *Int. Insolv. Rev.* 11.

¹⁰⁷ S 6(1) of the Insolvency Act.

This section is subject to two salient provisos, namely that the insolvent must possess sufficient assets to defray the costs of administration and that a definite advantage must be seen to accrue to his creditors.¹⁰⁸ It goes without saying that the aforementioned provisos play an indispensable role in preempting the onset of adverse creditor contributions.¹⁰⁹ The information used in determining the requisite sufficiency or benefit is procured from a statement of affairs, informally known as the CM100, which is compiled and lodged with the Master.¹¹⁰ Upon receipt thereof, the Master may direct the debtor, in terms of section 4(4), to have his assets formally appraised.¹¹¹ Although the underlying intention of this provision is sound, our courts have identified various abuses, discrepancies or mistruths regarding its implementation. This was exemplified in *Ex parte Cloete* where the court noted a recurring trend, whereby false or misleading valuations were adduced in order to prove a benefit to creditors.¹¹² The court in *Ex parte Cloete supra*, made the following observation:

“In many of these cases the valuations of the assets were either doubtful, or the sequestration costs and the administration costs pertaining to the liquidation and distribution of the estates were incorrectly calculated, presenting a false picture of the actual costs and the probable dividends payable to concurrent creditors” (emphasis added).¹¹³

Debtors have also demonstrated a clear propensity to furnish statements which do not accord with the true state of affairs. In amplification of this, the court in *In Ex parte Snooke* conceded that assertions made by debtors, in pursuing sequestration proceedings, were in many cases “far from the truth.”¹¹⁴ As a result, the court found it unsurprising that the majority of sequestrations did not result in a benefit to creditors.¹¹⁵ The inclination of debtors to portray a false reality, in which a fictitious advantage is conveyed, therefore remains problematic. On the converse, it could be argued that the recurring misrepresentations are a product of the advantage to creditors requirement’s

¹⁰⁸ S 6(1) of the Insolvency Act; Boraine & Roestoff 2014 *THRHR* 367.

¹⁰⁹ Roestoff & Boraine 2013 *De Jure* 225.

¹¹⁰ S 4(3) of the Insolvency Act.

¹¹¹ S 4(4) of the Insolvency Act.

¹¹² *Ex parte Cloete* 2013 JDR 0854 (FB).

¹¹³ *Ex parte Cloete supra* at 12.

¹¹⁴ *Ex parte Snooke* 2014 (5) 426 (FB) at 25.

¹¹⁵ *Ex parte Snooke supra* at 25.

exclusionary application, in that such persons are effectively barred from utilizing voluntary surrender as a debt relief mechanism. As such, debtors are forced to fabricate an artificial advantage to creditors by inflating the value of their estates. It thus appears that the rigid implementation of the requirement, in cases of voluntary surrender, may be prejudicial to both debtors and creditors alike.

Compulsory sequestrations employ a less taxing derivative of the advantage requirement, where it need only be proved that there is “reason to believe” that an advantage will vest in the general body of creditors.¹¹⁶ Due to the requirement being relatively lax, in comparison to voluntary surrender, there has been a remarkable influx of so-called friendly sequestrations.¹¹⁷ This relates to an application by a creditor for the compulsory sequestration of a debtor, to whom a direct affiliation or interconnectedness is apparent.¹¹⁸ The difficulty with such phenomenon is not the relationship *per se* but rather the underlying motive associated therewith.¹¹⁹ In this regard, friendly sequestrations are distinguishable from the conventional compulsory procedure, in that the creditor’s primary objective is the “discharge of debts” rather than the obtainment of an advantage to creditors.¹²⁰ In essence, this represents a collusive arrangement whereby parties seek to evade the stringent onus incumbent on debtors in terms of the voluntary surrender procedure. Although the requirement serves to eradicate creditor liability, the emergence of the aforesaid anomalies questions its overall effectiveness in achieving this objective. In exploring the prospect of legislative reform, one must therefore construe whether the advantage requirement could possibly be modified, supplemented, or redefined to rectify these discrepancies. This may envisage the incorporation of additional criteria, aimed specifically at verifying the veracity of an alleged benefit, as to prevent the commencement of sequestrations, which are unlikely to render any meaningful pecuniary advantage to creditors. Moreover, provision should be made for instances where there is no perceivable benefit nor is it likely that any benefit will be forthcoming in the foreseeable

¹¹⁶ Ss 10(c) and 12(1)(c) of the Insolvency Act; Loubser “Ensuring Advantage to Everyone in a Modern South African Insolvency Law” 1997 *S. Afr. Mercantile L.J.* 328.

¹¹⁷ Loubser 1997 *S. Afr. Mercantile L.J.* 327; Boraine & Roestoff 2014 *THRHR* 357.

¹¹⁸ Loubser 1997 *S. Afr. Mercantile L.J.* 327.

¹¹⁹ Loubser 1997 *S. Afr. Mercantile L.J.* 327.

¹²⁰ Loubser 1997 *S. Afr. Mercantile L.J.* 327; Boraine & Roestoff 2014 *THRHR* 365.

future. Boraine and Roestoff, in commenting on possible reform, have acknowledged the importance of retaining the advantage requirement, insofar as it serves to prevent instances of contribution.¹²¹ This can clearly be deduced from the following account:

“The advantage to creditors requirement serves an additional goal insofar as it ensures that sequestration will only be resorted to if it would be cost effective to do so, that is, if the proceeds of the residue would be sufficient to cover the costs of sequestration and to provide a pecuniary benefit to creditors. We therefore believe that the requirement should be retained for that purpose” (emphasis added).¹²²

In addition, Boraine and Roestoff suggest that courts should be endowed with a wider discretion in order to enable them to direct debtors, who have initiated sequestration proceedings, to invoke and/or seek alternative debt relief measures.¹²³ Thus, by exercising this new-found power of referral, a court may unilaterally terminate and/or discontinue proceedings which are unlikely to render a favorable return to creditors. This would ultimately assist with avoiding creditor-funded insolvencies, as sequestration would be deemed a procedure of ‘last resort’ to be invoked only in circumstances where there are sufficient proceeds to offset the costs of sequestration.¹²⁴

2.2.9 *The Apportionment of Liability Amongst the Concursum*

2.2.9.1 *Concurrent Creditors*

Creditors who do not possess security in support of their claims will rank amongst the concurrent portion of the *concursum*.¹²⁵ This classification can be further sub-divided into preferent and non-preferent creditors.¹²⁶ The term ‘concurrent creditors’ should thus be construed, for purposes of the current discourse, as referring to the latter. Section 103 of the Insolvency Act facilitates the payment of non-preferent concurrent claims pursuant to the discharge of all administrative expenses.¹²⁷ As such, concurrent creditors are entirely

¹²¹ Roestoff & Boraine 2013 *De Jure* 225.

¹²² Roestoff & Boraine 2013 *De Jure* 225.

¹²³ Roestoff & Boraine 2013 *De Jure* 225.

¹²⁴ Roestoff & Boraine 2013 *De Jure* 225.

¹²⁵ Vorster *Re-evaluating Statutory Preferences in Insolvency Law* (LLM Thesis UP 2018) 14.

¹²⁶ Vorster 2018 *LLM Thesis* 14.

¹²⁷ S 103 of the Insolvency Act.

reliant on there being sufficient surplus, in the free residue, to satisfy their claims.¹²⁸ Section 2 of the Insolvency Act defines free residue as being “that portion of an insolvent estate which is not subject to any right of preference by reason of any mortgage, legal hypothec, pledge or right of retention.”¹²⁹ In essence, this constitutes the unencumbered portion of the estate, from whence all non-preferent claims are to be paid.¹³⁰ Reliance on the free residue, however, attracts a reciprocal duty to contribute towards prospective deficiencies, namely where there is insufficient free residue to off-set the costs of sequestration.¹³¹ Should a deficiency arise, a concurrent creditor’s liability will be computed proportionally according to the value of his claim.¹³²

2.2.9.2 Secured Creditors

As traversed above, secured creditors may also look to the free residue as a means of settling the excess portion of their claims. This is evident from the wording of section 83(12), which allows secured creditors “to rank against the estate in respect of the excess, as an unsecured creditor.”¹³³ This interpretation was applied in the dicta of *Singer v The Master*, where court held as follows:

“A claim in respect of an excess under s 83(12) is an unsecured claim and as a matter of language it would seem to fall squarely within the terms of s 103(1)(a) of the Insolvency Act and be ranked in respect of the balance of the free residue of the estate in accordance with s 103(1)(a).”¹³⁴

Secured creditors, that elect to prove a claim for the excess, will therefore rank amongst the concurrent or unsecured creditors.¹³⁵ They will similarly incur a parallel obligation to contribute where there is an apparent shortfall in the free residue.¹³⁶ This is not applicable

¹²⁸ Bertelsman *et al* (2019) 559.

¹²⁹ S 2 of the Insolvency Act.

¹³⁰ Bertelsman *et al* (2019) 559.

¹³¹ Bertelsman *et al* (2019) 559; Burdette 1993 *De Rebus* 1005.

¹³² Bertelsman *et al* (2019) 559; Evans “Unfriendly Consequences of a Friendly Sequestration” 2003 *S. Afr. Mercantile L.J.* 441.

¹³³ S 83(12) of the Insolvency Act.

¹³⁴ *Singer v The Master* 1996 2 SA 133 (A) at 31.

¹³⁵ Burdette, “Insolvency: The Right of Secured Creditors to Post-Sequestration Interest” 2000 *J. S. Afr. L.* 621; Burdette 2003 *THRHR* 524.

¹³⁶ Bertelsman *et al* (2019) 559; Burdette 2003 *THRHR* 525.

where secured creditors have relied solely on the proceeds of their security in terms of section 89(2).¹³⁷ In addition to the concurrent portion of their claims, secured creditors will also assume an auxiliary liability where there are no concurrent creditors or if such creditors have refrained from proving their claims.¹³⁸ However, this only becomes necessary in the absence of a sequestrating creditor or where a secured creditor is the sole creditor in an insolvent estate.¹³⁹

2.2.9.3 *Preferent Creditors*

The claims of preferent creditors are conferred a statutory preference in terms of sections 96 to 102 of the Insolvency Act.¹⁴⁰ As a result, their claims will be paid in priority to other concurrent creditors in the estate.¹⁴¹ The circumstances surrounding the imposition of liability, on this class of creditors, is somewhat contentious.¹⁴² This is primarily due to certain interpretational difficulties and/or uncertainties owing to the omission of preferent creditors from the ambit of section 106.¹⁴³ Such uncertainties are encapsulated in *Mars*, which makes the following observation: “it is not clear from the wording of section s 106 whether or not unsecured preferent creditors can be held liable to contribute to any deficiency in the estate.”¹⁴⁴ Our courts have since clarified the position, by identifying the specific provision in section 106 that applies to preferent creditors.¹⁴⁵ The leading authority, in this respect, is the matter of *Ongevallekommissaris v Die Meester*, where the court deduced that preferent creditors will only be required to contribute in terms of section 106(c).¹⁴⁶ This provision pertains to a scenario whereby concurrent creditors have proven and subsequently withdrawn their claims.¹⁴⁷ In the absence of other proven creditors, the

¹³⁷ S 89(2) of the Insolvency Act; Burdette 2003 *THRHR* 524; Bertelsman *et al* (2019) 559.

¹³⁸ Bertelsman *et al* (2019) 560.

¹³⁹ Bertelsman *et al* (2019) 560.

¹⁴⁰ Ss 96 –102 of the Insolvency Act.

¹⁴¹ Bertelsman *et al* (2019) 561; Boraine & Van Wyk “Reconsidering the plight of the five foolish maidens: Should the unsecured creditor stake a claim in real security?” 2011 *THRHR* 349.

¹⁴² Bertelsman *et al* (2019) 561.

¹⁴³ Bertelsman *et al* (2019) 561.

¹⁴⁴ Bertelsman *et al* (2019) 561.

¹⁴⁵ Bertelsman *et al* (2019) 561; Evans 2003 *S. Afr. Mercantile L.J.* 442.

¹⁴⁶ *Ongevallekommissaris v Die Meester* 1989 (4) SA 69 (T); Bertelsman *et al* (2019) 561; Evans 2003 *S. Afr. Mercantile L.J.* 442.

¹⁴⁷ S 106(c) of the Insolvency Act; Bertelsman *et al* (2019) 561.

burden will befall the preferent creditors to make good any existing deficiency.¹⁴⁸ This will occur where the concurrent creditors have settled their liability, in accordance with section 106(b), and a shortfall still persists.¹⁴⁹ Burdette has welcomed the above judgment, which clarifies the distinct instances wherein preferential creditors will be required to contribute.¹⁵⁰

2.2.9.4 *Petitioning Creditor*

The presence of a petitioning creditor plays a pertinent role in the computation of creditor liability. As discussed, such creditor will assume an inherent or “compulsory” liability regardless of whether he has elected to prove a claim against the insolvent estate.¹⁵¹ The duty of a petitioning creditor originates from the wording of section 14(3) of the Insolvency Act, which provides that:

“In the event of a contribution by creditors under section one hundred and six, the petitioning creditor, whether or not he has proved a claim against the estate in terms of section forty-four, shall be liable to contribute not less than he would have had to contribute if he had proved the claim stated in his petition” (emphasis added).¹⁵²

A petitioning creditor must therefore take cognizance of this obligation, prior to instigating compulsory sequestration proceedings, as once the administrative process has been formally constituted, he will be unable to escape liability and will remain bound until the finalization of the estate.¹⁵³ The effect of section 14(3) is that the petitioning creditor cannot bring a sequestration application and rely on other creditors to pay the costs as a result of him not proving a claim.¹⁵⁴ Naturally, there is no petitioning creditor in cases of voluntary surrender.¹⁵⁵ The application of section 14(3) has been met with diverging and/or conflicting views by both the courts and academics alike. Burdette, in referring to

¹⁴⁸ S 106(c) of the Insolvency Act; Bertelsman *et al* (2019) 561.

¹⁴⁹ Bertelsman *et al* (2019) 561.

¹⁵⁰ Burdette 1993 *De Rebus* 1005.

¹⁵¹ Roestoff & Joubert 2019 *THRHR* 648.

¹⁵² Section 14(3) of the Insolvency Act.

¹⁵³ Roestoff & Joubert 2019 *THRHR* 648.

¹⁵⁴ Smith *et al Hockly's Law of Insolvency Winding Up and Business Rescue* (2019) 232; *FirstRand Bank Limited v Master of the High Court (Pretoria) and Others* (Case no 1120/19) 2021 (4) SA 115 (SCA) at 128.

¹⁵⁵ Smith *et al* (2019) 232.

the dictum of *Snyman v the Master*, disagreed with the court's finding that ABSA Bank Limited, the secured creditor, was liable to contribute.¹⁵⁶ Burdette's contention was premised, *inter alia*, on the presence of a petitioning creditor coupled with the bank's reliance on its security in terms of section 89(2).¹⁵⁷ In approaching the issue, the court determined that "all creditors" who had proven claims against estate were liable to contribute, irrespective of whether they had relied on their security in terms of section 89(2).¹⁵⁸ Burdette accordingly asserted that the learned judge had erred in his interpretation of section 106, by ascribing a "rather narrow and isolated interpretation" to the first segment of the provision.¹⁵⁹

In dissenting further, Burdette criticized the court's failure to consider the impact of section 14(3) on the apportionment of liability.¹⁶⁰ These contentions form a compelling argument, which illustrate the need to address certain *lacuna* prevailing in South Africa's insolvency law. In particular, the misinterpretation, non-implementation and/or general disregard of the statutory provisions aimed at easing creditor contributions. Although it may be argued that the imputation of liability, on a single creditor, is discriminatory and/or disproportionate, such practice must be construed in view of the provision's intrinsic purpose. In commenting on this, Burdette remarked that "clearly this section was designed to ensure that there will always be someone to pay the contribution in cases of compulsory sequestration."¹⁶¹ Since this process is initiated at the instance of a particular creditor, it seems appropriate that such creditor bear the financial obligation of defraying the costs of sequestration. Roestoff and Joubert emit a similar view by stating that it is "reasonable to expect the latter [applicant creditors] to make good the deficiency."¹⁶² This essentially results in a single creditor being adversely implicated instead of the *concursum* as a whole. Section 14(3) is therefore instrumental in confining the detrimental effects of contribution to the person/entity responsible for commencing the sequestration process. Notwithstanding this, the *Snyman* judgment presents a perturbing reality wherein

¹⁵⁶ *Snyman v the Master* 2003 1 SA 239 (T); Burdette 2003 *THRHR* 521.

¹⁵⁷ Burdette 2003 *THRHR* 523.

¹⁵⁸ *Snyman v The Master supra* at 243I – 244A.

¹⁵⁹ Burdette 2003 *THRHR* 523.

¹⁶⁰ Burdette 2003 *THRHR* 523.

¹⁶¹ Burdette 2003 *THRHR* 527.

¹⁶² Roestoff & Joubert 2019 *THRHR* 650.

circumvention measures, such as sections 14(3) and 89(2), are not being appropriately enforced.

In the *First Rand* case supra, the *court a quo* came to a similar conclusion. In this regard, Vilakazi AJ held that the secured creditors were proportionally liable to contribute in conjunction with the petitioning creditor.¹⁶³ Whilst the court did adopt the correct interpretation of section 14(3), it erred in conferring a contributory obligation on the secured creditors.¹⁶⁴ This point was raised by Roestoff and Joubert, who made the following observation:

“It is submitted that the court correctly held that the body corporate was liable to contribute towards the deficiency in the free residue. However, it is not clear why the two bond-holders who relied on their security should have been held liable pro rata together with the body corporate” (emphasis added).¹⁶⁵

Our courts have thus demonstrated a clear propensity to disregard or “overlook” avoidance mechanisms contained in the Insolvency Act.¹⁶⁶ On appeal, however, the court took an entirely different stance. Pursuant to conducting an extensive interpretative analysis of the relevant provisions of sections 14, 89 and 106 of the Insolvency Act, Mabindla-Boqwana AJA dissented with the court of first instance. In her judgment, the learned Judge disagreed with the dictum of *Snyman* by deducing that the interpretation proffered therein “does violence to section 89(2) and its purpose” and similarly “overlooks the provisions of s 14(3).”¹⁶⁷ The judgment compounds and/or reiterates the initial sentiments adduced by Burdette and can be construed as a triumph for the future circumvention of creditor contributions. Given the recurring issues experienced with the interpretation and subsequent implementation of these provisions, it may be prudent for the legislature to consider supplementing, modifying, or amending the current wording to foster a more practical application and understanding of these sections. Roestoff and Joubert second this suggestion by emphasizing that the ambiguity surrounding the

¹⁶³ *First Rand Bank v The Master of the High Court*.

¹⁶⁴ Roestoff & Joubert 2019 *THRHR* 651.

¹⁶⁵ Roestoff & Joubert 2019 *THRHR* 651.

¹⁶⁶ *First Rand Bank v The Master of the High Court supra* at 40.

¹⁶⁷ *First Rand Bank v The Master of the High Court supra* at 40.

interpretation of existing contribution provisions “is clearly an issue which needs to be addressed by the legislator” (emphasis added).¹⁶⁸

2.2.10 *The Costs of Sequestration: Section 97*

The incurrance of certain costs in the administrative process is an inevitable reality. It is therefore necessary to briefly outline the expenditure that forms part of and/or gives rise to a corresponding liability to contribute. It is common cause that contribution is a consequence of there being insufficient surplus to offset the costs of sequestration.¹⁶⁹ Sequestration costs can be largely defined as the costs incurred during the administration of the insolvent estate.¹⁷⁰ In terms of section 97(2), these costs are broadly categorized into three respective groups, which include sheriffs’ fees, Master’s fees and an assortment of charges and salaries owing to certain persons and/or entities.¹⁷¹ Section 97(3) of the Insolvency Act relates to the recovery of the taxed costs sustained in obtaining the final sequestration order.¹⁷² In particular, the provision accommodates those costs:

“incurred in connection with the petition of the debtor for acceptance of the surrender of his estate or of a creditor for the sequestration for the sequestration of the debtor’s estate, but it does not include the costs of opposition to such a petition, unless the court directs that they shall be included” (emphasis added).¹⁷³

The above may be construed as being slightly ambiguous, as one could assume, from a plain reading thereof, that this refers solely to the costs incurred by the petitioning creditor. However, in *Ex Parte The Merchants’ Trust Ltd*, the court rectified this common misconception, by asserting that the provision applied to any creditor who had petitioned for the sequestration of the debtor’s estate.¹⁷⁴ This employs a wider interpretation where other creditors, directly involved in the sequestration procedure, are able to recover their taxed costs. In making the aforesaid deduction, Barry J reasoned, *inter alia*, that the

¹⁶⁸ Roestoff & Joubert 2019 *THRHR* 651.

¹⁶⁹ Bertelsman *et al* (2019) 531.

¹⁷⁰ Bertelsman *et al* (2019) 531.

¹⁷¹ S 97 of the Insolvency Act; Bertelsman *et al* (2019) 531.

¹⁷² S 97(3) of the Insolvency Act.

¹⁷³ S 97(3) of the Insolvency Act.

¹⁷⁴ *Ex Parte The Merchants’ Trust Ltd* 1930 TPD 142; Bertelsman *et al* (2019) 532.

Insolvency Act already accommodated the costs of the petitioning creditor.¹⁷⁵ This is evidenced by section 14(2) of the Insolvency Act, which directs the trustee to pay the petitioning creditor “out of the first funds of the estate available for that purpose.”¹⁷⁶ The decision in *Merchants’ Trust* supra, formed part of the recent judgment of *Vincemus Investments (Pty) Ltd v Bekker N.O. and Others In re: Vincemus Investments (Pty) Ltd v Travea (Pty) Ltd*, where Binns-Ward J relied on the said dictum to determine whether the creditor’s costs constituted costs of sequestration in terms of section 97 of the Insolvency Act.¹⁷⁷ The advantage of section 97(3) is self-evident, in that it allows certain creditors to recover the costs of initiating sequestration proceedings. This is only plausible, however, where there is an adequate sufficiency of monies to distribute amongst such creditors.

The broad and seemingly non-exhaustive construction of section 97(2)(c), envisages an extensive array of costs which are deductible from the free residue. These include, *inter alia*, the taxed costs of sequestration, the reasonable remuneration of the trustee, the charges of the Master and the salaries or fees of persons who have rendered services to the estate.¹⁷⁸ Of particular interest, for purposes of the current discourse, is the remuneration of the trustee and the fees payable to the attorneys appointed to act on behalf of the estate.¹⁷⁹ This is largely due to the extensive and seemingly limitless nature of such costs. In terms of the former, section 63 of the Insolvency Act entitles a trustee to receive “a reasonable remuneration” for services rendered during the administrative process.¹⁸⁰ Section 384(1) and (2) of the Companies Act similarly permit liquidators to be reasonably compensated for their services.¹⁸¹ The trustee’s remuneration is taxed by the Master in accordance with Tariff B of the Second Schedule of the Insolvency Act.¹⁸² Importantly, the Master has a wide discretionary power, whereby he may reduce, increase or disallow any portion of the trustee’s remuneration.¹⁸³ The supervisory function

¹⁷⁵ *Ex Parte The Merchants’ Trust Ltd supra* at 146.

¹⁷⁶ S 14(2) of the Insolvency Act.

¹⁷⁷ *Vincemus Investments (Pty) Ltd v Bekker N.O. and Others In re: Vincemus Investments (Pty) Ltd v Travea (Pty) Ltd (12477/2020)* 2022 ZAWCHC 207 at 11.

¹⁷⁸ S 97(2)(c) of the Insolvency Act.

¹⁷⁹ Bertelsman *et al* (2019) 535.

¹⁸⁰ S 63(1) of the Insolvency Act; Bertelsman *et al* (2019) 535.

¹⁸¹ S 384(1) & (2) of the Companies Act.

¹⁸² Tariff B of the Second Schedule of the Insolvency Act.

¹⁸³ S 63(1) of the Insolvency Act; Bertelsman *et al* (2019) 535.

espoused by the Master is thus vital in ensuring that trustees/liquidators do not unduly impoverish the estate by charging exorbitant amounts. In *Klopper v The Master of the High Court*, the court dismissed the liquidator's application to review and set aside the Master's refusal to increase his remuneration.¹⁸⁴ In substantiation thereof, the court ruled that the time, effort and complexity of administering the estate did not warrant the increased fee.¹⁸⁵ This judgment reaffirms the role of the Master in regulating the pecuniary benefit accruable to trustees or liquidators and the prevention of possible abuse or unscrupulous conduct in relation thereto.

In dealing with attorneys' fees, it is necessary to consult the provisions of section 73 of the Insolvency Act, which enables trustees or liquidators to seek legal assistance with the requisite authorization of the creditors.¹⁸⁶ It should be noted, however, that such requirement may be dispensed with in cases of urgency.¹⁸⁷ In these instances, the Master is approached for the required authorization without having to first acquire the imprimatur of the creditors.¹⁸⁸ Section 73(2) makes provision for the exclusion of taxation by mutual written agreement between the attorney and trustee on a specific fee tariff.¹⁸⁹ Although the section does not indicate the applicable tariff, a tariff has been framed under *Government Notice (GNR)*. 733 of 1981, which sets out the computation of legal fees chargeable against the estate.¹⁹⁰ In cases of disagreement or dispute, the matter will be submitted for assessment to the relevant law society.¹⁹¹ Despite the preexisting safeguards mentioned therein, the provision is moot and/or ambiguous on the necessity of creditor approval in the conclusion of fee agreements. From an initial observation, it appears that pre-creditor authorization will only be required in respect of contingency fee agreements.¹⁹² The requirement of creditor authorization is thereafter introduced, albeit indirectly, through the ambit of section 73(4)(a), which directs the trustee to attest, by

¹⁸⁴ *Klopper NO v Master of the High Court* (643/07) [2008] ZASCA 155; 2009 (3) SA 571 (SCA); [2009] 2 All SA 39 (SCA).

¹⁸⁵ *Klopper NO v Master of the High Court supra* at 13.

¹⁸⁶ S 73 of the Insolvency Act.

¹⁸⁷ S 73(1)(a) of the Insolvency Act.

¹⁸⁸ S 73(1)(a) of the Insolvency Act.

¹⁸⁹ S 73(2) of the Insolvency Act.

¹⁹⁰ *Government Notice (GNR)*. 733 of 1981.

¹⁹¹ S 73(3) of the Insolvency Act.

¹⁹² S 73(2) of the Insolvency Act; Bertelsman *et al* (2019) 535.

written declaration, that the requisite authorization was obtained prior to the execution of any fee agreement.¹⁹³ It may therefore be judicious for the legislature to consider amending section 73(2) to expressly indicate that creditor approval is required in terms of all fee agreements and not just those pertaining to contingency fee arrangements. Importantly, the trustee is also required to affirm that he was not “overreached” by such attorneys or counsel in the performance of their duties.¹⁹⁴ The section incorporates “all costs incurred by the trustee, including any costs awarded against the estate in legal proceedings” (emphasis added).¹⁹⁵ Moreover, it provides that these costs will “be included in the costs of the sequestration of the estate.”¹⁹⁶ This will ultimately impact the *concursum*, as they will be required to settle any deficit arising from adverse or punitive cost orders granted against the estate. It may therefore seem rather iniquitous that the creditors must bear the financial detriment associated with failed litigation proceedings.

Whilst the blame cannot, in all instances, be squarely attributed to the trustee or his attorneys, the question remains whether creditors should be held liable in circumstances where such parties have failed to prosecute or defend such proceedings with the requisite skill, diligence or competency. In addressing this, it does appear that the legislature foresaw such an eventuality. Section 73(5) of the Insolvency Act grants the Master the necessary authority to disallow or preclude certain costs, where it has been determined that these are “incorrect or improper or that the trustee acted in bad faith, negligently or unreasonably in incurring any such costs.”¹⁹⁷ In the same sense, section 74 allows a competent court to impose liability upon attorneys or counsel, who have “improperly advised the institution, defence, or conducting of legal proceedings.”¹⁹⁸ Such provisions are clearly aimed at dissuading trustees and attorneys from engaging in frivolous legal proceedings, where there are no material prospects of success. It is trite that the only true benefactors, in such proceedings, are the attorneys themselves with the creditors having

¹⁹³ S 73(4)(a) of the Insolvency Act; Bertelsman *et al* (2019) 535.

¹⁹⁴ S 73(4)(d) of the Insolvency Act; Bertelsman *et al* (2019) 535.

¹⁹⁵ S 73(1) of the Insolvency Act; Bertelsman *et al* (2019) 535.

¹⁹⁶ S 73(1) of the Insolvency Act; Bertelsman *et al* (2019) 535.

¹⁹⁷ S 73(5) of the Insolvency Act; Bertelsman *et al* (2019) 535.

¹⁹⁸ S 74 of the Insolvency Act.

to ultimately 'fit the bill.' In *van der Walt v Murray and Another*, Naidoo J expounded on the aforementioned scenario by stating the following:

"Litigation of this nature and conduct such as I have described have the only consequence of incurring unnecessary costs, which the insolvent estate must bear, to the prejudice of the creditors" (emphasis added)¹⁹⁹

Given the discernible *nexus* between sequestrations costs and the levying of contributions, it is understandable why the legislature has sought to employ various mitigation protocols, such as the discretionary function of the Master, tariffs and the imposition of liability in circumstances of unscrupulous conduct. Such efforts are highly commendable and deserving of recognition. However, it could be argued that such measures omit or are moot on the issue of contribution. In this respect, it is unclear whether the Master, in exercising his discretion to disallow, reduce or increase certain costs, must first consider the financial liquidity of the free residue and the ensuing effects on the creditors of the insolvent estate. Similarly, the various tariffs and/or regulations do not account for circumstances of apparent shortfall in the determination of a trustee's remuneration or the fees payable to attorneys. In the same sense, section 74 does not indicate whether attorneys, who have improperly advised the estate, will be liable to contribute towards a deficiency in the estate, should it later arise. By incorporating express provisions that take due cognizance of contribution, the legislature could effectively reduce, limit or alleviate the necessity of contributions.

2.2.11 *Withdrawal of a Proven Claim*

Where a creditor elects to subsequently withdraw his claim, pursuant to the proof thereof, he may still be required to contribute in terms of section 51 as read with section 106(b) of the Insolvency Act.²⁰⁰ Accordingly, a creditor must weigh-up whether the imminent threat of contribution warrants the ramifications of withdrawing his claim. Section 51(1) enables creditors to withdraw their claims by notifying the Master and the trustee of their intention

¹⁹⁹ *Van der Walt v Murray and Another* (2554/2019) [2019] ZAFSHC 169 at 24.

²⁰⁰ Ss 51 & 106(b) of the Insolvency Act; Bertelsman *et al* (2019) 449.

to do so.²⁰¹ In terms of the proviso to this section, the creditor will retain a contingent liability to contribute for “his pro rata share of the costs of sequestration and all costs lawfully incurred by the trustee in connection with the sequestration up to the date he received the creditor’s letter of withdrawal.”²⁰² The aforesaid must be read in conjunction with section 106(b) of the Insolvency Act, which provides that if creditors withdraw their claims, within five days after the passing of a creditors’ resolution, they will not incur any ensuing liability emanating therefrom.²⁰³ By employing these provisions, creditors may therefore limit their overall exposure by effectively ‘cutting their losses’ and walking away from the sequestration process. On the one hand, this could lead to increased creditor passivity, dissociation, and non-participation in administrative proceedings. On the other hand, it could be perceived as a useful alternative to mitigate risk. Evans, in concurring with the latter argument, regards the withdrawal procedure as an efficient means of lessening the burden of contribution.²⁰⁴ As briefly mentioned, should a shortfall persist after the levying and payment of a contribution, by the withdrawing creditors, then the remaining proven creditors will need to settle the deficit.²⁰⁵ As confirmed, in the *Ongevallekommissaris* judgment, this does not include secured creditors, who have sought immunity in terms of section 89(2), but does extend to preferent unsecured creditors.²⁰⁶

2.2.12 Statutory Enforcement: Collection of Contributions

Despite this discourse being centered around the circumvention of creditor contributions, one must briefly consider the practical implications pertaining to the enforcement of contributory obligations. In particular, it must be considered how the Insolvency Act regulates the collection of contributions from creditors who are unable to pay the amounts demanded. At the outset, section 118(1) of the Insolvency Act sanctions the recovery of contributions through an expedited debt enforcement mechanism.²⁰⁷ This entails the

²⁰¹ S 51(1) of the Insolvency Act; Bertelsman *et al* (2019) 449.

²⁰² S 51(1) of the Insolvency Act; Bertelsman *et al* (2019) 449.

²⁰³ S 106(b) of the Insolvency Act; Evans 1995 *S. Afr. Mercantile L.J.* 85.

²⁰⁴ Evans 1995 *S. Afr. Mercantile L.J.* 89.

²⁰⁵ Bertelsman *et al* (2019) 449.

²⁰⁶ *Ongevallekommissaris v Die Meester*.

²⁰⁷ S 118(1) of the Insolvency Act; Bertelsman *et al* (2019) 561.

issuing of a warrant of execution after a letter has been sent directing and/or demanding the creditor to pay the contribution amount.²⁰⁸ It is self-evident that the legislature sought to prevent the incurrence of added legal expense by escalating the recovery process. This seems rather drastic, as a trustee may completely forego all legal process and, upon the expiry of thirty days from the date of transmission of the letter, obtain a warrant authorizing the sheriff to execute against the movable assets of the creditor.²⁰⁹ It could be argued that this defeats the purpose of administrative proceedings, which is to obtain a benefit for all creditors that comprise the *concursum*.²¹⁰ Whilst the incurrence of sequestration costs is an inevitable reality, one must consider whether alternative measures could be employed to elude the ultimate prosecution of persons and/or entities who have already suffered substantial financial adversity at the hands of the insolvent.

The Insolvency Act further provides for circumstances wherein creditors are unable to pay the demanded contribution. According to *Mars*, with reference to section 118(2) of the Insolvency Act, the appropriate recourse, in such instances, is for the trustee to “frame and submit to the Master a supplementary plan of contribution”, wherein the residual liability will be distributed amongst those proven creditors who are able to satisfy the debt.²¹¹ Should the same predicament befall other creditors, the trustee must repeat the process by framing a further supplementary plan, whereby the liability is once more apportioned amongst the remaining creditors.²¹² Significantly, the Act does not make provision for instances where all remaining creditors are unable to pay the outstanding contribution. The Act omits reference to circumstances in which the trustee or Master are aware that certain creditors are unable to settle the contribution by virtue of their insolvency. However, legal precedent does exist which suggests that these creditors be excluded from the supplementary plan of contribution.²¹³ This was the position in *Peycke*

²⁰⁸ S 118(1) of the Insolvency Act; Bertelsman *et al* (2019) 561.

²⁰⁹ S 118(1) of the Insolvency Act; Bertelsman *et al* (2019) 561.

²¹⁰ *Seevnarayan v Ramjathan supra*.

²¹¹ S 118(2) of the Insolvency Act; Bertelsman *et al* (2019) 562.

²¹² S 118(2) of the Insolvency Act; Bertelsman *et al* (2019) 562.

²¹³ S 118(2) of the Insolvency Act; Bertelsman *et al* (2019) 562; *Peycke & Co v Seagull* 26 SC 374.

& *Co v Estate Seagull*, where the court held that certain creditors, who had become insolvent, had been rightly omitted from the supplementary plan.²¹⁴

2.3 The Draft Insolvency Bill: An Effective Circumvention Instrument?

The reformation of the existing insolvency regime has been a pertinent consideration for almost three decades.²¹⁵ Despite such ordeals, it is evident that the original construction of the Insolvency Act has remained largely unchanged.²¹⁶ The advent of the recent 2015 insolvency Bill thus presents an intriguing new development, which could effectively shape the nature and extent of creditor liability in South Africa.²¹⁷ In order to assess whether the Bill constitutes an effective circumvention instrument, one must duly consider the specific provisions relating to contribution. The first notable addition is found in section 42(2)(b) of the Bill, which deals with the liquidator's report to creditors.²¹⁸ In terms of this section, the liquidator is required to adduce an on opinion on "whether there is a risk of a contribution by creditors in terms of section 99, or [to] indicate why he or she is unable to express an opinion on the matter" (emphasis added).²¹⁹ The inclusion of an express reporting prerequisite recognizes the necessity of informing creditors of the impending risk of contribution. This will enable creditors to effectively assess the feasibility of proving their claims. It is further commendable that the liquidator must explain his inability to furnish an opinion, as this will inevitably discourage liquidators from withholding vital information regarding the possibility of contribution.²²⁰

The furnishing of security to the Master, in terms of section 9(3)(b) of the Insolvency Act, has also been significantly adjusted.²²¹ In terms of sections 3(3)(b), 4(4)(b) and 5(3)(a)(iii) of the Bill, the applicant or petitioning creditor will be required provide security "for the payment of all costs that might be awarded against the applicant and all costs of

²¹⁴ *Peycke & Co v Seagull supra*.

²¹⁵ Calitz "Historical Overview of State Regulation of South African Insolvency Law" 2019. *Fundamina: A Journal of Legal History* 1.

²¹⁶ Calitz 2019 *Fundamina: J Legal Hist* 1.

²¹⁷ The Bill.

²¹⁸ S 42(2)(b) of the Bill.

²¹⁹ S 42(2)(b) of the Bill.

²²⁰ S 42(2)(b) of the Bill.

²²¹ S 9(3)(b) of the Insolvency Act.

liquidation which are not recoverable from other creditors of the estate” (emphasis added).²²² This effectively broadens the existing security perimeters, thereby imputing greater liability on either the applicant or petitioning creditor, as the case may be. The explanatory memorandum details the inherent advantage of such provision, in cases of voluntary surrender where there are no proven creditors, by stating the following:

“By providing security the estate will be assured of payment of the costs of liquidation. This will also ensure that members think twice before liquidating the debtor voluntarily by resolution, as they will ultimately be held liable for the costs of liquidation should there be insufficient funds” (emphasis added).²²³

The benefit is accordingly twofold in that it indemnifies the estate of the associated sequestration costs, whilst simultaneously deterring insolvents from frivolously surrendering their estates. Interestingly, the Bill omits the sufficient asset requirement, contained in section 6(1) of the Insolvency Act, by contending that it “does not add” to the existing advantage of creditors requirement.²²⁴ Although there is merit to such contention, one could argue that the sufficient asset requirement is a useful tool in determining whether an actual advantage will accrue to creditors. This is achieved by assessing the value of the realizable property in connection with the costs of sequestration. Notwithstanding this exclusion, the advantage to creditors requirement has been duly retained in the Bill, as observed in sections 3(8)(a)(ii), 10(1)(c)(i) and 11(1)(c).²²⁵ Moreover, the scope of the said requirement has been extended to the first meeting of creditors. Section 46(6) of the Bill indicates that the issue of advantage to creditors must be considered during the first meeting, where the meeting is convened prior to the granting of the final liquidation order.²²⁶ Upon the *concursum* reaching a final determination on this “question”, the liquidator will compile a report detailing the outcome or findings that were considered.²²⁷ This report will thereafter be lodged with the court

²²² Ss 3(3)(b), 4(4)(b) and 5(3)(a)(iii) of the Bill.

²²³ *The Explanatory Memorandum on the Draft Bill* (“**the Memorandum**”) at 31 – 32.

²²⁴ S 6(1) of the Insolvency Act; the Memorandum at 24.

²²⁵ Ss 3(8)(a)(ii), 10(1)(c)(i) and 11(1)(c) of the Bill.

²²⁶ S 46(6) of the Bill.

²²⁷ S 46(6) of the Bill.

prior to the granting of the final liquidation order.²²⁸ This could be construed as a valuable pre-emptive measure, as creditors would be afforded an extra opportunity to assess whether the continuation of the winding-up process would render a favourable return. Although not expressly indicated, it can be reasonably inferred that a competent court would be hesitant, if not reluctant, to grant a final liquidation order, where the creditors have deduced that there is little to no prospect of them deriving any discernible benefit. This would effectively lead to the early termination and/or discontinuation of the winding-up procedure, thereby preventing the estate from incurring unnecessary expense.

In addressing the issue of exorbitant fees, the Bill is seen to place reliance on the recommendations canvassed in the NEDLAC Interim report on the Insolvency and Business Recovery Bill (“**NEDLAC report**”).²²⁹ In addition, section 85(4) widens the Master’s existing discretion by enabling it to disallow fees which are considered to be “excessive.”²³⁰ The inclusion of this additional criteria will better equip the Master in determining whether such costs were properly incurred during the administration of the estate. This could assist with reducing the costs of sequestration which will, in turn, diminish the risk of contribution. In commenting on the discretion exercised by the Master, the NEDLAC report conceded that the “application of the discretion by the Master is a concern.”²³¹ This is premised, *inter alia*, on the various inconsistencies associated with the Master and the effectiveness of its operation. Despite this, it asserts that the discretion of the Master remains a necessary component in evaluating the fees charged by liquidators and/or attorneys and should therefore be retained.²³²

The Bill does contain certain innovative solutions in circumventing the onset of creditor funded insolvencies. This is evident from, *inter alia*, the inclusion of additional reporting standards, the furnishing of broader security and the extension of the advantage of creditors requirement. Whilst these demonstrate a clear intention to avoid or pre-empt contributions, it is unfortunate that the Bill does not envisage distinct avoidance protocols,

²²⁸ S 46(6) of the Bill.

²²⁹ The NEDLAC Interim report on the Insolvency and Business Recovery Bill (“**the NEDLAC report**”).

²³⁰ S 85(4) of the Bill.

²³¹ The NEDLAC report; the Memorandum at 85.

²³² The NEDLAC report; the Memorandum at 85.

aimed at mitigating and/or preventing instances of insufficiency. Given the upsurge of contributions, it would seem apposite for the legislature to incorporate a separate distinct provision, specifically designed to prevent creditor liability. Such protocols could include, for example, auxiliary duties on the trustee/liquidator to conduct preliminary assessments on the nature, scope and extent of costs that would be incurred during the administration of the estate. Notwithstanding this, whilst the Bill is a proverbial 'step in the right direction' it retains the contributory component of its predecessor.

2.4 Conclusion

The South African insolvency framework is clearly predicated on a contributory construct, wherein the imposition of creditor liability, in form of statutory endorsed contributions, has remained the *modus operandi* in defraying the costs of sequestration where there is insufficient free residue in the estate. This is primarily achieved through the ambit of two salient provisions of the Insolvency Act, being sections 89 and 106. However, these provisions cannot be construed in isolation and must be reviewed in close proximity with other pertinent sections of the Insolvency Act, which have both a direct or indirect bearing on the imputation of creditor liability. In addressing whether the prevailing *status quo* makes adequate provision for the circumvention of creditor contributions, it was deduced that whilst an array of pre-emptive measures are manifest within the existing statutory framework, there remains a series of *lacunae* which effectively perpetuate the concept of creditor-funded insolvencies. It is submitted that the amendments and/or additions contained in the Bill do constitute an intriguing new development with additional reporting and security standards aimed at preventing contributions. However, the Bill omits a separate contribution provision and excludes existing prerequisites aimed at contribution avoidance. This accordingly necessitates further reformative intervention, wherein the issue of creditor liability is given appropriate attention.

Chapter 3: International Alternatives to Creditor-funded Insolvencies: an Exposition of Bankruptcy Protocols employed in Germany and the United Kingdom

3.1 Introduction

Foreign bankruptcy systems have devised a series of innovative “funding mechanisms” which replace adverse creditor liability with debtor-funded initiatives and state-regulated administrations.²³³ These include, *inter alia*, the introduction of cost-deferral provisions; the discharge of residual debt; the early termination of deficient proceedings; judicial restructuring; and the cross-subsidization of state administrations.²³⁴ These form part of distinct insolvency constructs, which denote universal trends of financing assetless insolvencies.²³⁵ The insolvency regimes of Germany and the UK exhibit diverse methods of funding impecunious or destitute sequestrations, without directly implicating the *concursum*. Such procedures are contained in the German Insolvency Code (*Insolvenzordnung*) and the UK Insolvency Act together with several ancillary rules and regulations.²³⁶ Interestingly, these structures differ remarkably, with each jurisdiction formulating a particular approach to the defrayment of sequestration costs.²³⁷ The German position implements various pre-emptive techniques which are designed to prevent, defer or discontinue insolvency proceedings where funds are inadequate to finance the projected costs.²³⁸ Germany has thus opted for a proverbial ‘prevention is better than cure’ approach by inhibiting the consequences of asset-deprived insolvencies. On the converse, the UK employs a hybrid system of state administration and preferential debt restructuring.²³⁹ This is exemplified through the extensive functions of the official

²³³ van Dijck “How to fund assetless estates in insolvency? assessing European funding mechanisms” 2014 *EFCR* 136.

²³⁴ van Dijck 2014 *EFCR* 147.

²³⁵ van Dijck 2014 *EFCR* 147.

²³⁶ German Insolvency Code available at:

https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html (accessed 1 October 2023); the UK Insolvency Act available at: <https://www.legislation.gov.uk/ukpga/1986/45/contents> (accessed: 1 October 2023).

²³⁷ van Dijck 2014 *EFCR* 137.

²³⁸ van Dijck 2014 *EFCR* 147; Ss 4a, 211 and 289 of the German Insolvency Code; Roestoff & Coetzee “Debt relief for South African NINA debtors and what can be learned from the European approach” 2017 *CILSA* 262.

²³⁹ van Dijck 2014 *EFCR* 143 – 144; Tribe “The Lightfoot paradox: financing the costs of personal insolvency relief through bankruptcy revenue stamps and sliding scales” 2016 *Insolvency*

receiver and the exercise of judicial discretion by UK courts.²⁴⁰ Each of the foregoing systems provide prospective means of reducing the contributory burden often experienced by South African creditors. However, these systems are not without their limitations and must be viewed in light of South Africa's unique socio-economic dispensation.²⁴¹ It is thus apposite to examine each of these Eurocentric constructions to determine whether they offer true reformative alternatives to South Africa's prevailing *status quo*.

3.2 The Domestic Position: South Africa's Adherence to a Model of Estate-funding

As a point of departure, one must first investigate the apparent *nexus* existing between South Africa's insolvency law and the universal model of estate-funding.²⁴² As illustrated, South Africa's bankruptcy policy espouses a contributory structure, in which insufficiencies are defrayed solely by proven creditors.²⁴³ This is predominately achieved through the exactment of statutory contributions.²⁴⁴ This framework accords with the conventional model of estate funding whereby internal financing measures are employed to fund distressed insolvencies.²⁴⁵ Despite domestic adherence, this model is by no means a *sui generis* construct and is observed in various foreign jurisdictions.²⁴⁶ This model essentially entails that bankruptcy proceedings are "funded from the insolvency estate, more specifically the creditors of the particular insolvency procedure" (emphasis added).²⁴⁷ From the aforesaid, it is apparent that estate-funding is highly synonymous with the phenomenon of creditor-funded insolvencies. The efficacy of this model, from both an international and domestic perspective, is questionable with empirical studies revealing negligible creditor recoveries.²⁴⁸ On commenting on its apparent shortcomings,

²⁴⁰ *Intelligence* 39; S 156 of the UK Insolvency Act; Keay, Boraime & Burdette "Preferential debts in corporate insolvency: a comparative study" 2001 *Int. Insolv. Rev.* 171.

²⁴¹ Keay *et al* 2001 *Int. Insolv. Rev.* 174; S 156 of the UK Insolvency Act; van Dijck 2014 *EFCR* 147; van Dijck & Gramatikov "What determines bankruptcy costs?" 2009 *TISCO Working Paper Series on Civil Law and Conflict Resolution System 2*.

²⁴² van Dijck 2014 *EFCR* 137.

²⁴³ van Dijck 2014 *EFCR* 146.

²⁴⁴ S 106 of the Insolvency Act; Bertelsman *et al* (2019) 558.

²⁴⁵ S 106 of the Insolvency Act; Bertelsman *et al* (2019) 558.

²⁴⁶ van Dijck 2014 *EFCR* 138; van Dijck and Gramatikov 2009 *TISCO Working Paper 2*.

²⁴⁷ van Dijck 2014 *EFCR* 138.

²⁴⁸ van Dijck 2014 *EFCR* 137.

van Dijck 2014 *EFCR* 139.

van Dijck describes estate-funding as “a vulnerable mechanism...which provides insufficient or even improper financial incentives.”²⁴⁹ In order to digress from this pro-liability paradigm, viable alternatives must be identified which subsidize or avert cash-starved sequestrations without directly implicating creditors.

3.3 International Bankruptcy Policies: The German Bankruptcy System

3.3.1 *Introduction*

Germany’s response to asset-deprived insolvencies is premised on a formalistic system of legislative deferrals, discharge procedures, preemptory asset requirements and early termination protocols.²⁵⁰ These measures are codified within a single all-encompassing instrument known as the German Insolvency Code.²⁵¹ This “unified” statutory arrangement provides for both personal and consumer bankruptcy procedures which envisage either the continuation of insolvencies, through cost-deferral, or the premature termination due to a lack of assets.²⁵² A salient feature of Germany’s bankruptcy system is the various “out-of-court” settlement prerequisites which precede the initiation of formal insolvency proceedings.²⁵³ These broadly consist of debtor-creditor negotiations and state-funded debt counselling initiatives.²⁵⁴ Such endeavors preclude the necessity of expensive court procedures by facilitating constructive engagements that fall outside the ambit of formal bankruptcy procedures.²⁵⁵ On commenting on the underlying objective of this process, Kilborn adduces the following explanation: “It hopes to reduce cost and alleviate stress on the formal judicial process by facilitating and enhancing out-of-court

²⁴⁹ van Dijck 2014 *EFCR* 154.

²⁵⁰ Ss 4a, 26 & 207 of the German Insolvency Code; van Dijck 2014 *EFCR* 147; Braun “German Insolvency Act: Special Provisions of Consumer Insolvency Proceedings and the Discharge of Residual Debts” 2006 *Ger. Law J* 59.

²⁵¹ Braun 2006 *Ger. Law J* 59; Kaiser “European Bankruptcy Laws: Implications for Corporations Facing Financial Distress” 1996 *Financial Management* 74.

²⁵² Kaiser 1996 *Financial Management* 74.

²⁵³ Braun 2006 *Ger. Law J* 63; Roestoff & Coetzee 2017 *CILSA* 261.

²⁵⁴ Braun 2006 *Ger. Law J* 69; Roestoff & Coetzee 2017 *CILSA* 261; S 306(1) of the German Insolvency Code; Kilborn “The Innovative German Approach to Consumer Debt Relief: Revolutionary Changes in German Law, and Surprising Lessons for the United States” 2004 *Nw. J. Int’l L. & Bus.* 272 – 273.

²⁵⁵ Kilborn 2004 *Nw. J. Int’l L. & Bus.* 272.

debt arrangements.”²⁵⁶ Roestoff and Coetzee refer to the patent shortcomings of external settlement endeavors by making the following observation:

“This obligatory out-of-court settlement procedure has not proved effective in providing a solution to the consumers’ financial problems and is clearly an inappropriate and wasteful measure for NINA debtors, as they do not have any assets or income on the basis of which to make any acceptable or realistic offer to their creditors.”²⁵⁷

Additionally, these pre-sequestration settlement protocols have been plagued by financial constraints, prolonged waiting periods and fragile implementation.²⁵⁸ In the premise, it is unlikely that compulsory settlement discussions would effectively pre-empt the risk of contribution in the long run. Should these endeavors fail, insolvency proceedings will ultimately ensue.²⁵⁹ Once formal proceedings have commenced, debtors may resort to either ordinary or consumer bankruptcy proceedings, depending on their classification (i.e., natural or juristic).²⁶⁰ Ordinary or “regular” proceedings apply to economically autonomous natural persons as well as to juristic entities.²⁶¹ The aim of these proceedings is to liquidate available assets for distribution amongst creditors, alternatively, to facilitate the reorganization of a debtor’s financial affairs.²⁶² On the converse, consumer bankruptcy proceedings pertain solely to natural persons, with the primary objective being the discharge of residual debt.²⁶³ Each of the foregoing exhibit different methods for the mitigation of creditor liability.

3.3.2 *The Deferment of Administrative Costs through the Discharge of Residual Debt*

The term ‘legislative deferrals’ pertains to section 4a of the German Insolvency Code, which permits natural-person debtors to defer payment of administrative costs upon a

²⁵⁶ Kilborn 2004 *Nw. J. Int’l L. & Bus.* 288.

²⁵⁷ Roestoff & Coetzee 2017 *CILSA* 270 – 271.

²⁵⁸ Roestoff & Coetzee 2017 *CILSA* 261 – 261; Kilborn 2004 *Nw. J. Int’l L. & Bus.* 277.

²⁵⁹ Braun 2006 *Ger. Law J* 69; Roestoff & Coetzee 2017 *CILSA* 262; Ss 311–314 of the German Insolvency Code; Kilborn 2004 *Nw. J. Int’l L. & Bus.* 278.

²⁶⁰ Braun 2006 *Ger. Law J* 61, 65 & 66.

²⁶¹ Braun 2006 *Ger. Law J* 61; Ss 11-216 of the German Insolvency Code.

²⁶² Braun 2006 *Ger. Law J* 61; Ss 11-216 of the German Insolvency Code.

²⁶³ Braun 2006 *Ger. Law J* 61; Ss 304-314 of the German Insolvency Code.

formal petition to “discharge residual debt.”²⁶⁴ Discharge proceedings constitute a “special consumer insolvency procedure” designed to extinguish pre-insolvency debt upon the fulfilment of certain socio-economic responsibilities.²⁶⁵ At the outset, and as general rule, a debtor’s petition for discharge may be accompanied or joined with a further request to “open” formal insolvency proceedings.²⁶⁶ Upon commencement, debtors will be subject to a six-year probationary period, known as the period of “good behavior”, during which they must surrender all nonexempt assets and “all nonexempt work-related income” to the appointed trustee.²⁶⁷ This signifies a self-funding repayment scheme, in which debtors assume the socio-economic responsibility of settling their over-indebtedness. This self-instigated process effectively accommodates so-called NINA debtors (‘no income no assets’) by enabling them to utilize bankruptcy protocols to liquidate their prehistoric debt.²⁶⁸ In doing so, it counters the exclusionary nature of notorious minimum asset requirements and provides a “simplified” debt relief mechanism.²⁶⁹ Kilborn alludes to the reformatory impact of this procedure by noting that “before cost-deferral reform in 2001, 90% of consumer insolvency cases under the Insolvency Act were dismissed for lack of assets” (emphasis added).²⁷⁰

The deferment of administrative expenditure forms part of Germany’s distinct “forbearance model” (*Stundungsmodell*), which places a *moratorium* on the payment of insolvency costs pending the discharge of residual debt.²⁷¹ The costs incurred in these proceedings are offset against available funds or assets subsisting within the estate.²⁷² Heuer outlines the defrayment process as follows:

²⁶⁴ S 4a of the German Insolvency Code; Braun 2006 *Ger. Law J* 61; Roestoff & Coetzee 2017 *CILSA* 262; Kilborn 2004 *Nw. J. Int’l L. & Bus.* 279.

²⁶⁵ Braun 2006 *Ger. Law J* 61; Roestoff & Coetzee 2017 *CILSA* 263.

²⁶⁶ S 287 of the German Insolvency Code.

²⁶⁷ Kilborn 2004 *Nw. J. Int’l L. & Bus.* 279; Roestoff & Coetzee 2017 *CILSA* 263; Heuer “Hurdles to debt relief for “no income no assets” debtors in Germany: A case study of failed consumer bankruptcy law reforms” 2020 *Int. Insolv. Rev.* s46.

²⁶⁸ Heuer 2020 *Int. Insolv. Rev.* s52; Braun 2006 *Ger. Law J* 66; Roestoff & Coetzee 2017 *CILSA* 269; Kilborn 2004 *Nw. J. Int’l L. & Bus.* 279.

²⁶⁹ Kilborn 2004 *Nw. J. Int’l L. & Bus.* 277; Roestoff & Coetzee 2017 *CILSA* 262; Braun 2006 *Ger. Law J* 65.

²⁷⁰ Kilborn 2004 *Nw. J. Int’l L. & Bus.* 277.

²⁷¹ Heuer 2020 *Int. Insolv. Rev.* s52.

²⁷² Heuer 2020 *Int. Insolv. Rev.* s52.

“Any proceeds from the debtor's bankruptcy and discharge proceedings should be used to cover the costs of the proceedings before any payments to creditors were made. Costs remaining after the discharge proceeding should be deferred for another 4 years and then waived.”²⁷³

What is significant from the foregoing, is that creditors do not assume any monetary duty to settle or “make good” outstanding deficiencies.²⁷⁴ Instead, shortfalls are deferred and ultimately waived at the State’s expense.²⁷⁵ In addition, debtors retain the primary financial onus of expelling insolvency expenditure. To achieve this, the German Insolvency Code prescribes certain socio-economic responsibilities, which must be fulfilled by debtors during the period of “assignment” or “good behavior.”²⁷⁶ For example, sections 287b and 295(1) of the Insolvency Code require debtors to seek and procure viable sources of distributable income, which can be used, *inter alia*, to satisfy creditors’ claims, off-set existing expenditure and fund the continuation of bankruptcy proceedings.²⁷⁷ Debtors are thus instilled with a “strong sense of responsibility for dealing with their financial affairs” through their active participation in the insolvency process.²⁷⁸ Pursuant to discharge, debtors remain liable to repay all deferred costs through structured instalments.²⁷⁹ In the event of debtors being incapable of meeting their respective repayment obligations, section 4b(1) of the Insolvency Code provides that German courts may exercise a discretion by extending the deferment period and setting reasonable

²⁷³ Heuer 2020 *Int. Insolv. Rev.* s52.

²⁷⁴ Section 106 of the Insolvency Act provides that proven creditors are “liable to make good any deficiency” in circumstances where there is insufficient free residue to defray administrative costs.

²⁷⁵ Heuer 2020 *Int. Insolv. Rev.* s52.

²⁷⁶ Kilborn 2004 *Nw. J. Int’l L. & Bus.* 277; Roestoff & Coetzee 2017 *CILSA* 269.

²⁷⁷ S 287b of the German Insolvency Code provides that “From the beginning of the assignment period up until the termination of the insolvency proceedings it is incumbent on the debtor to engage in appropriate gainful employment and, if unemployed, to seek such employment and not refuse any reasonable activity.” This relates to the discharge procedure canvassed in Part 9 of the Insolvency Code; S 295 of the German Insolvency Code further refers to specific debtor obligations during the so-called assignment period or period of good behavior. This provision requires debtors to “engage in appropriate gainful employment or, if unemployed, to seek such employment and not refuse any reasonable activity”; Braun 2006 *Ger. Law J* 68.

²⁷⁸ Kilborn 2004 *Nw. J. Int’l L. & Bus.* 294; Roestoff & Coetzee 2017 *CILSA* 269; Braucher “A Law-in-Action Approach to Comparative Study of Repayment Forms of Consumer Bankruptcy” 2009 Arizona Legal Studies Discussion Paper No. 08-09 346.

²⁷⁹ Braun 2006 *Ger. Law J* 61.

“monthly instalments.”²⁸⁰ This provision essentially constitutes a repayment plan which facilitates the incremental settlement of deferred administrative costs by the debtor himself. The omission of adverse contributory liability coupled with the alluring prospect of debtor-discharge suggests that Germany has achieved an ‘equilibrium’ between debtor and creditor rights within the context of consumer bankruptcy. Kilborn commends such efforts by expressing that:

“German lawmakers have created an impressive set of theoretical benefits and trade-offs, which demands a carefully balanced quid pro quo of debtors and creditors affected by consumer bankruptcy.”²⁸¹

Notwithstanding the preclusion of liability, in the form of creditor contributions, this procedure negates a discernible benefit to creditors.²⁸² Instead, it is seen to prioritize the debtor’s “resocialization and re-entry into the open credit economy” above the obtainment of a favorable distribution to creditors.²⁸³ This alarming reality defies the fundamental objective of German insolvency law which is to procure, realize and distribute the assets amongst the debtor’s known creditors.²⁸⁴ The absence of a clear benefit to creditors is primarily due to the prolonged, convoluted and/or complex nature of German insolvency proceedings.²⁸⁵ This inevitably results in the incurrance of exorbitant administrative fees which are eventually deferred and later waived.²⁸⁶ In addressing its long and tedious

²⁸⁰ Section 4b (1) of the German Insolvency Code provides that: “If the debtor is unable, once discharge of residual debt has been granted, to pay the deferred amount from his or her income and assets, the court may extend deferment and set the monthly instalments to be paid”; Braun 2006 *Ger. Law J* 61.

²⁸¹ Kilborn 2004 *Nw. J. Int’l L. & Bus.* 294.

²⁸² Kilborn 2004 *Nw. J. Int’l L. & Bus.* 294 & 296; Roestoff & Coetzee 2017 *CILSA* 269 -270.

²⁸³ Kilborn 2004 *Nw. J. Int’l L. & Bus.* 296; Roestoff & Coetzee 2017 *CILSA* 269 -270.

²⁸⁴ Section 1 of the German Insolvency Code provides that “Insolvency proceedings serve the collective satisfaction of a debtor’s creditors by means of liquidation of the debtor’s assets and distribution of the proceeds or by reaching an arrangement in an insolvency plan.” Whilst German discharge and cost-deferral protocols exclude creditor contributions, such mechanisms rarely result in a favourable distribution to creditors. This contradicts the primary objective of German insolvency proceedings, as envisaged in section 1 of the Insolvency Code.

²⁸⁵ Heuer 2020 *Int. Insolv. Rev.* s55; Roestoff & Coetzee 2017 *CILSA* 269; Kilborn 2004 *Nw. J. Int’l L. & Bus.* 272.

²⁸⁶ Roestoff & Coetzee 2017 *CILSA* 269; Heuer 2020 *Int. Insolv. Rev.* s52.

application, Roestoff and Coetzee recommend that the procedure be shortened to accord with international standards.²⁸⁷ This is evident from the following statement:

“It is submitted that lawmakers should, in light of the vital educational purpose it fulfils, rather adopt the traditional earned-discharge approach for all debtors, but for a shorter waiting period of three years which period correspond to internationally preferred principles.”²⁸⁸

Like South Africa, Germany’s hierarchical structure of distribution dictates that insolvency costs must be paid in preference to the claims of creditors.²⁸⁹ As such, creditors will seldomly receive payment due to an insufficiency of distributable funds. This questions the perceived symmetry of German consumer bankruptcy, in that debtors may attain, somewhat undeservingly, discharge without paying the vast majority of their creditors. Despite the appealing prospects of a debtor-funded insolvency system, it appears that the perceived benefits envisaged therein are largely “illusory” with creditors often receiving the “short end of the stick.”²⁹⁰ Braun reiterates this skeptical reality by indicating that “discharge will always be granted in favour of the debtor and for the disadvantage of the creditor and the State.”²⁹¹ Although problematic, this does not detract from the intrinsic value that discharge and cost-deferral policies could potentially offer towards the circumvention of creditor-funded insolvencies in South Africa.

As indicated *infra*, the deferral of administrative costs enables debtors, who possess little to no assets, to utilize formal insolvency procedures to discharge their pre-existing debt.²⁹² The ensuing costs of this process are borne directly by the debtor and/or by the State, with creditors assuming a more subordinate role therein.²⁹³ Discharge prerequisites further oblige debtors to fulfill certain socio-economic roles which include obtaining gainful employment to self-fund the defrayment of administrative costs.²⁹⁴

²⁸⁷ Roestoff & Coetzee 2017 *CILSA* 270.

²⁸⁸ Roestoff & Coetzee 2017 *CILSA* 270.

²⁸⁹ Heuer 2020 *Int. Insolv. Rev.* s52; S 53 of the German Insolvency Act indicates that “the insolvency estate is to be used to settle in advance the costs of the insolvency proceedings and the other debts incumbent on the estate.”

²⁹⁰ Kilborn 2004 *Nw. J. Int’l L. & Bus.* 294 - 295.

²⁹¹ Braun 2006 *Ger. Law J* 70.

²⁹² S 4a of the German Insolvency Code.

²⁹³ Heuer 2020 *Int. Insolv. Rev.* s60.

²⁹⁴ Ss 287b and 295(1) of the German Insolvency Code.

Significantly, section 292(1) of the Insolvency Code makes further provision for trustees to effect an annual *pro rata* distribution to creditors from amounts accumulated from debtor/third-party payments.²⁹⁵ This incentivizes the process by offering creditors an annual return or ‘pay-out’ from the debtor’s non-exempt income. Of course, this assumes that there are funds available for distribution after the payment of administrative costs. The importation of deferred debtor funding initiatives, coupled with discharge, within the South African bankruptcy context, could engender a more efficient system of financing assetless insolvencies, without the need to exact contributions from creditors. The assignment of income-generating obligations could theoretically create a greater sense of social responsibility amongst debtors by requiring them to actively participate in the reduction of their indebtedness. More importantly, debtors would effectively ‘self-fund’ their own sequestration proceedings by surrendering a portion of their non-exempt income. It should be noted that these obligations would need to be vetted against South Africa’s unique economic climate, in order to ascertain whether it would be reasonable to require debtors to procure income in a country known for having scarce or limited employment opportunities.²⁹⁶ Although the South African and German fiscal structures differ remarkably, this does not render such policies incapable of domestic application. In adducing a comparative account of German and Ethiopian bankruptcy protocols, Getahun decisively professes that “consumer bankruptcy law designed after the German Model will benefit Ethiopia.”²⁹⁷ In addition, Getahun effectively endorses the concept of debtor-funded insolvencies, coupled with the appropriate discharge, by stating that “Repayment plan with discharge and fresh start for successful debtors who will pay cost of proceeding and a certain portion of debt will be a good option” (emphasis added).²⁹⁸ Given this inter-continental comparison, it is plausible to assert that the German system of cost deferral,

²⁹⁵ Section 291(1) of the German Insolvency Code provides that “...the trustee must keep separate the amounts received under such assignment and any other payments contributed by the debtor or third parties from his or her own property and distribute them annually to the insolvency creditors as directed in the final record...”

²⁹⁶ As at the second quarter of 2023, the South African unemployment rate stands at 32.6% - “South Africa unemployment rate” <https://tradingeconomics.com/south-africa/unemployment-rate> (accessed 7 October 2023). The introduction of strict socio-economic responsibilities would therefore place a considerable burden on South African debtors.

²⁹⁷ Getahun “Consumer Bankruptcy Law for Ethiopia: Lessons from United States and Germany” 2014 *HLR* 45.

²⁹⁸ Getahun 2014 *HLR* 44.

residual debt discharge and self-financing (debtor-funded insolvencies) could find corresponding application in South African insolvency law.

3.3.3 *Sufficient Asset Requirement and Refusal to Open Insolvency Proceedings*

Germany's ordinary insolvency procedure is characterized by stringent deterrence provisions devised to thwart the commencement of asset-deficient insolvencies. In essence, debtors who possess insufficient assets to off-set administrative expense, will not be permitted to "open" formal insolvency proceedings.²⁹⁹ This bears a remarkable resemblance to the minimum asset requirement envisaged in section 6 of the South African Insolvency Act.³⁰⁰ The rationale for this prerequisite is self-evident, with its primary objective being to obviate the incurrence of extensive expenditure in the pursuance of futile insolvency proceedings. In this respect, section 26(1) of the Insolvency Code dictates that "the insolvency court refuses a request to open insolvency proceedings if the debtor's assets will probably be insufficient to cover the costs of the proceedings."³⁰¹ This is subject to the provisos that a request will not be refused where adequate funds have been furnished to cover the associated costs, alternatively, where the costs have been deferred in terms of section 4a of the Insolvency Code.³⁰² Importantly, funds may only be advanced by certain stakeholders, being "the requesting party, the creditors and, third parties."³⁰³ Notwithstanding the bid for external funding opportunities, van Dijck submits that there is "no real advantage for them [creditors or third parties] to do so."³⁰⁴ Indeed, there is no plausible reason to expend resources on a process that is unlikely to render a favorable return, as to do so would merely amount to poor business acumen.

The inevitable consequence of the 'sufficiency requirement' is that many debtors are denied the opportunity to commence insolvency proceedings due to an inherent lack of

²⁹⁹ S 26 of the German Insolvency Code; van Dijck 2014 *EFCR* 147.

³⁰⁰ Section 6 of the Insolvency Act pertains to the voluntary surrender of a debtor's estate. The provision contains a prerequisite that a court must be satisfied that the petitioning debtor "...owns realizable property of a sufficient value to defray all costs of the sequestration...".

³⁰¹ S 26(1) of the German Insolvency Code; van Dijck 2014 *EFCR* 147.

³⁰² S 26(1) of the German Insolvency Code.

³⁰³ Herchen "Article 30: advance payment of costs and expenses" in Pannen (ed) *European Insolvency Regulation: Commentary* (2011) 447.

³⁰⁴ van Dijck 2014 *EFCR* 147.

assets. The propensity of German courts to refuse such requests is well-documented with empirical studies demonstrating high refusal rates.³⁰⁵ Whilst many commentators disagree with the requirements rigid and exclusionary implementation, it does successfully counteract impending shortages by pre-empting the onset of assetless insolvencies.³⁰⁶ German legislators have thus sought to eliminate this occurrence by ensuring that only certain debtors, with sufficient liquidity to defray administrative costs, are given the requisite imprimatur to commence insolvency proceedings. It is worth mentioning that the sufficiency requirement is further integrated and/or imbedded into the duties of the provisional insolvency administrator.³⁰⁷ Section 22 of the Insolvency Code, confers a positive duty on provisional administrators to:

“verify whether the debtor’s property will cover the costs of the insolvency proceedings; in addition, the insolvency court may charge the insolvency administrator with verifying, as an expert, whether a reason to open insolvency proceedings exists.”³⁰⁸

This constitutes an additional safeguard for the prevention of illiquid insolvencies and the avoidance of a corresponding liability to contribute. As such, it could be valuable addition to the existing statutory duties and/or functions of South African trustees. Although contentious, the incorporation of the sufficiency requirement remains integral to the prevention of imminent post-commencement deficiencies.

However, it should be noted that the refusal to open formal insolvency proceedings has serious implications on the legal status of the petitioning debtor.³⁰⁹ In this respect, such persons and/or entitles effectively lose their “legal competence to act” and may only subsist on the condition that they divest and distribute their available assets amongst known creditors and shareholders.³¹⁰ This process is known as *Auflösung* and denotes a

³⁰⁵ van Dijck 2014 *EFCR* 147. van Dijck refers to statistical studies, which demonstrate a historic refusal rate of approximately 46%. This denotes the stringent application of the sufficiency requirement by German courts. Moreover, it evidences high exclusion rates for debtors who possess little to no assets (so-called NINA debtors). However, it could be argued that the introduction of discharge and cost-deferral mechanisms have, to a certain extent, countered the exclusionary effect of this requirement, insofar as natural person debtors are concerned.

³⁰⁶ van Dijck 2014 *EFCR* 147.

³⁰⁷ S 22 of the German Insolvency Code.

³⁰⁸ S 22 of the German Insolvency Code.

³⁰⁹ van Dijck 2014 *EFCR* 147.

³¹⁰ van Dijck 2014 *EFCR* 147.

winding-up undertaken solely by debtors themselves.³¹¹ Due to the self-governing nature of this procedure, it not surprising that there have been numerous instances of abuse, maladministration, asset depletion and undue preference.³¹² Accordingly, it is submitted that whilst Germany's sufficient asset requirement proves an effective deterrence instrument, which indirectly averts the need for post-commencement financing, it does result in severe legal ramifications for both debtors and creditors alike. This calls for the formation of a separate procedure, designed specifically for administering the estates of NINA debtors, in a manner that is both expedient and cost-effective given the illiquidity of the debtor's estate.

3.3.4 *Early Termination Procedures*

The German Insolvency Code further provides for an early termination procedure in circumstances where: the "opening grounds" have ceased to exist; the creditors have expressly assented to the termination; and the assets are no longer sufficient to cover the costs.³¹³ The latter instance could prove beneficial for purposes of the current discourse. It is submitted that by discontinuing asset-deficient insolvencies, the German legislature has demonstrated considerable foresight in avoiding potential financing dilemmas. The cessation of the insolvency process, coupled with the sufficient asset requirement, enables the German system to effectively eliminate potential irregularities without incurring substantial expense. In particular, section 207(1) of the Insolvency Code provides that:

"If, after the insolvency proceedings have been opened, it is found that the insolvency estate is insufficient to cover the costs of the proceedings, the insolvency court discontinues such proceedings."³¹⁴

³¹¹ van Dijck 2014 *EFCR* 147.

³¹² van Dijck 2014 *EFCR* 147.

³¹³ Closset & Urban "The balance of power between creditors and the firm: Evidence from German insolvency law" 2019 *J.Corp.Finance* 8; Ss 207, 212 and 213 of the German Insolvency Code.

³¹⁴ S 207(1) of the German Insolvency Code.

In addition, section 207(3) of the Insolvency Code mandates the trustee to utilize available funds to “settle the costs of the proceedings” prior to termination.³¹⁵ At present, the South African Insolvency Act permits the Master or insolvent, through the ambit of section 54(5), to petition for the setting aside of the sequestration order, in the event of a provisional trustee not being appointed.³¹⁶ The provision does not specify any additional criteria, which warrant the setting aside of the sequestration order, and it appears that the only condition is the non-appointment of a provisional trustee. As such, the provision lacks the appropriate scope and/or authority to enable interested parties to seek the discontinuation of asset-deprived proceedings. The petition is not mandatory nor is there any obligation on the Master to seek the setting aside of the order. In contrast, the German system contains a specific termination provision, which compels the court to discontinue proceedings where there are insufficient assets to settle the sequestration debt.³¹⁷ It would therefore be prudent for section 54 to incorporate a similar duty which obliges the Master, in particular, to petition for the setting aside of the sequestration order, in circumstances where there are insufficient assets. This would significantly curtail the duration of futile sequestration proceedings and prevent the incurrence of additional expense. In turn, this would eliminate and/or remove the risk of contribution in its entirety.

This forward-thinking approach would be a worthy addition to South Africa’s existing framework, by offering an expedient way to discontinue the administration of hopelessly insolvent estates. By intercepting distressed insolvencies, at an early stage, the costs and duration of insolvency proceedings could be drastically curtailed. This would prove highly beneficial where debtors have self-fabricated a perceived benefit to creditors, by disproportionately elevating the value of their assets. In such instances, judicial oversight could be employed to terminate ill-conceived insolvencies, which were based on false or misleading information. This would substantially reduce the risk of contribution by limiting administrative costs and allowing creditors to seek alternative remedies for the

³¹⁵ Section 207(3) of the German Insolvency Code provides that “any cash funds available in the insolvency estate are to be used by the administrator prior to discontinuation of the proceedings to settle the costs of the proceedings, and among such costs firstly expenses in proportion to their amounts”.

³¹⁶ S 54(5) of the Insolvency Act.

³¹⁷ S 207(1) of the Insolvency Act.

satisfaction of their claims. Notwithstanding the aforesaid, it should be noted that the legal consequences of discontinuation present a precarious scenario, whereby debtors are reinvested and/or regain control over their property.³¹⁸ In terms of section 211(2) of the German Insolvency Code, it is indicated that “upon discontinuation of the insolvency proceedings, the right to freely realise the insolvency estate transfers back to the debtor”.³¹⁹ As such, debtors will be at liberty to dispose and/or distribute their assets in manner that could potentially prejudice and/or duly favour certain creditors above others. Furthermore, debtors will not obtain an immediate discharge of their residual debt and will need to apply for such discharge after the discontinuation process has been appropriately finalised.³²⁰

3.4 International Bankruptcy Policies: The United Kingdom

3.4.1 Introduction

Unlike Germany’s model of passive deterrence, the UK resembles a more active ‘state-funded’ bankruptcy system, in which external stakeholders assume the financial onus of funding asset-strapped insolvencies.³²¹ This ‘active’ stance is reiterated by Kerstana-Vaks, who notes that “the dominant view in the UK is that no insolvency case should be left unscrutinised for lack of the requisite funds.”³²² To achieve this, the UK has integrated elements of government intervention and judicial oversight into its existing insolvency framework.³²³ Such elements have led to the system being defined as “pervasively governmental and administrative in character.”³²⁴ In terms of its structure, UK bankruptcy policy is divided into personal and corporate procedures, which are contained in separate

³¹⁸ S 211 of the German Insolvency Code.

³¹⁹ S 211(2) of the German Insolvency Code.

³²⁰ Section 286 of the German Insolvency Code provides that “If the insolvency proceedings are discontinued, discharge of residual debt may only be granted if, after notification of the insufficiency of the assets, the insolvency estate has been distributed pursuant to section 209 and the proceedings are discontinued pursuant to section 211.”

³²¹ van Dijck 2014 *EFCR* 142.

³²² Kerstana-Vaks “Available Options for Funding the Insolvency Proceeding of Corporate Debtors” 2015 *Juridica Int’l* 84.

³²³ S 156 of the UK Insolvency Act; van Dijck 2014 *EFCR* 142; Calitz “System of Regulation of South African Insolvency Law: Lessons from the United Kingdom” 2008 *Obiter* 360; Keay *et al* 2001 *Int. Insolv. Rev* 171; Kerstana-Vaks 2015 *Juridica Int’l* 84.

³²⁴ Skeel “The Genius of the 1898 Bankruptcy Act” 1999 *Bankruptcy Developments* 328; Calitz 2008 *Obiter* 360.

sections of the UK Insolvency Act.³²⁵ This is further supplemented by ancillary rules, such as the UK Insolvency Rules of 1986 (“**the 1986 rules**”), which have subsequently been amended by the UK Insolvency (England and Wales) Rules of 2016 (“**the 2016 rules**”).³²⁶ As indicated, the UK has opted for a state-orientated approach to the administration of impoverished estates. This is presented under the auspices of official receivership which refers to governmental administration of insolvent estates.³²⁷ Moreover, the exercise of judicial direction, in restructuring preferential debts, could also prove a valuable circumvention instrument for the South African insolvency system.³²⁸ In short, this would enable courts to elevate or demote the preference assigned to sequestration costs, which could potentially lessen the burden foisted upon South African creditors. In the premise, one must carefully consider the financial implications associated with these procedures to ascertain whether they constitute viable alternatives to creditor contributions.

3.4.2 *Official Receivership*

Official receivership pertains to an institutional paradigm in which the state serves as the appointed trustee/liquidator of assetless insolvencies.³²⁹ The appointment of official receivers is typically reserved for “bankruptcies that contain no considerable assets.”³³⁰ Conversely, estates with sufficient assets will usually be transferred from the official receiver to an independent trustee or liquidator.³³¹ Trustees or liquidators will generally refuse appointments where estates possess insufficient assets to defray their costs.³³² Goode reaffirms this position by expressing that:

³²⁵ Keay *et al* 2001 *Int. Insolv. Rev.* 171; UK Insolvency Act available at: <https://www.legislation.gov.uk/ukpga/1986/45/contents> (accessed: 7 October 2023).

³²⁶ UK Insolvency Rules of 1986 available at: <https://www.legislation.gov.uk/uksi/1986/1925/contents/made> (accessed: 7 October 2023). UK Insolvency Rules (England and Wales) of 2016 available at: <https://www.legislation.gov.uk/uksi/2016/1024/crossheading/introductory-rules/made> (accessed 7 October 2023).

³²⁷ van Dijck 2014 *EFCR* 142; Calitz 2008 *Obiter* 360.

³²⁸ S156 of the UK Insolvency Act.

³²⁹ Calitz 2008 *Obiter* 360; van Dijck & Gramatikov 2009 *TISCO Working Paper 2*.

³³⁰ van Dijck & Gramatikov 2009 *TISCO Working Paper 2*.

³³¹ van Dijck & Gramatikov 2009 *TISCO Working Paper 2*.

³³² Goode *Principles of Corporate Insolvency Law* (2011) 160.

“In practice an outside liquidator will not accept an appointment unless he or she is satisfied that there are at least enough assets to cover the expenses of the winding-up, including the liquidator’s remuneration” (emphasis added).³³³

Official receivers and trustees therefore bear reciprocal obligations to ascertain whether insolvent estates possess sufficient assets to warrant external non-state administration. The functions of the official receiver broadly envisage the protection, realization and distribution of assets amongst creditors.³³⁴ This further incorporates an investigative component whereby official receivers are mandated to investigate nefarious activities, including misconduct and related offences, and to institute the necessary recovery proceedings in respect thereto.³³⁵ The Master constitutes the South African equivalent of the official receiver, being the state-entity responsible for the supervision of South African insolvency proceedings.³³⁶ Despite various similarities between the official receiver and the Master, it is evident that the former exhibits a more extensive range of administrative powers. Calitz confirms this by noting that, unlike its foreign counterpart, the Master “lacks the power to oversee the administration of an insolvent estate personally.”³³⁷ In addition, Calitz alludes to the Master’s “lack of investigative powers”, which must be exercised by trustees or liquidators at the expense of the estate.³³⁸ Whilst official receivership constitutes a formal government process, its operation is not strictly financed through state-sponsorship.³³⁹ Instead, funding is acquired through prescribed tariffs which are selectively charged against estates that possess a sufficient quantity of liquid assets.³⁴⁰ van Dijck and Gramatikov expand on this process by stating that:

“The system of Official Receivership is financed through case administration fees which are levied in bankruptcy cases that contain a certain amount of assets. Consequently, the

³³³ Goode (2011) 160.

³³⁴ Calitz 2008 *Obiter* 360; Joubert & Calitz “To Be or Not to Be? The Rule of Private Enquiries in the South African Insolvency Law” 2014 *PER/PELJ* 914.

³³⁵ Calitz 2008 *Obiter* 363; Joubert & Calitz 2014 *PER/PELJ* 914 - 915; S 132 of the UK Insolvency Act refers to the specific investigative powers conferred on the official receiver.

³³⁶ Joubert & Calitz 2014 *PER/PELJ* 899; Calitz 2008 *Obiter* 363; Calitz “Some thoughts on state regulation of South African insolvency law” 2011 *De Jure* 299.

³³⁷ Calitz 2008 *Obiter* 369.

³³⁸ Calitz 2011 *De Jure* 299.

³³⁹ van Dijck 2014 *EFCR* 142; van Dijck & Gramatikov 2009 *TISCO Working Paper* 2.

³⁴⁰ van Dijck & Gramatikov 2009 *TISCO Working Paper* 2-3.

creditors in asset-rich bankruptcies carry the financial burden of the winding up of estates that lack considerable assets. Therefore, what seems to be state funding at first, as the ORs are paid by the state, turns out to be a type of cross-subsidization.”³⁴¹

One could perceive this as a classic example of ‘robbing Peter to pay Paul’ in that creditors of “asset-rich” estates are required, albeit indirectly, to finance the administration of assetless estates.³⁴² This effectively amounts to an indirect form of creditor-funding which “conflicts with the idea that insolvencies should maximize creditors’ profits.”³⁴³ Notwithstanding this, official receivership does proffer an efficient form of state administration which accommodates insolvencies that fall below a certain asset threshold. This further dissuades trustees and liquidators from accepting appointments in estates devoid of sufficient surplus to offset their fees. The extension of the Master’s existing administrative powers, to incorporate further investigative capacities, would theoretically circumvent the need to appoint external trustees or liquidators for such purposes. This would significantly reduce the costs associated with insolvency investigations. In practical terms, however, this is highly improbable as it presupposes that the Master possesses the requisite capacity or competencies to undertake such investigations. Given the known limitations of the Master, it does not seem appropriate to import and impose additional functions on a state institution that is already overburdened.³⁴⁴ To do so, would merely thwart or hamper its existing functionality and lead to further maladministration and delays.

³⁴¹ van Dijck & Gramatikov 2009 *TISCO Working Paper 2-3*.

³⁴² van Dijck & Gramatikov 2009 *TISCO Working Paper 2-3*.

³⁴³ van Dijck 2014 *EFCR* 142.

³⁴⁴ According to a recent report by the Portfolio Committee on Justice and Correctional Services, concern was expressed regarding the “deplorable state of the Master’s Office” and the lack of effective initiatives to address the “significant” backlog. Accordingly, the Master does not possess the requisite capacity to take on further investigate functions - “Report of the Portfolio Committee on Justice and Correctional Services on the Annual Performance Plans 2023/24 of the Department of Justice and Constitutional Development, National Prosecuting Authority, Legal Aid South Africa, Special Investigating Unit, Public Protector South Africa, South African Human Rights Commission and Information Regulator, and Budget Vote 25: Justice and Constitutional Development for the 2023 MTEF, dated 2 June 2023” available at: <https://pmg.org.za/taled-committee-report/5406/> (accessed: 7 October 2023).

3.4.3 *Judicial Discretion and the Restructuring of Preferential Expenditure*

The UK's non-classification of liquidation expenditure, as a preferential debt, contrasts from the South African position of statutory preference.³⁴⁵ In this regard, the UK demonstrates a more flexible approach to the priority assigned to insolvency costs.³⁴⁶ This alludes to the discretionary competence of UK courts to restructure the payment of liquidation expense, in certain circumstances, by elevating, demoting and/or adjusting the preference assigned thereto.³⁴⁷ This discretionary function is reserved specifically for circumstances where there is an apparent shortfall or insufficiency of assets.³⁴⁸ Despite this, the UK exhibits a similar disposition to South Africa in terms of the order in which costs are to be paid.³⁴⁹ In this respect, it is accepted that liquidation costs must be settled before there can be a ratable distribution to creditors.³⁵⁰ In ascertaining the appropriate definition of "liquidation expenses" in terms of UK insolvency law, rule 3.50 of the 2016 rules provides as follows:

"all fees, costs, charges and other expenses incurred in the course of the administration are to be treated as expenses of the administration."³⁵¹

This broad, all-encompassing, description casts a wide 'net' in respect of the prospective costs which can form part thereof. Rules 6.42 and 7.108 (previously 4.218) clarifies and/or refines this description by adducing a comprehensive list of liquidation costs and the specific order of priority assigned thereto.³⁵² It should be noted that rule 6.42 pertains to expenses incurred in voluntary proceedings, whilst rule 7.108 refers to compulsory

³⁴⁵ Keay *et al* 2001 *Int. Insolv. Rev.* 170.

³⁴⁶ Keay *et al* 2001 *Int. Insolv. Rev.* 170 – 171.

³⁴⁷ Keay *et al* 2001 *Int. Insolv. Rev.* 170 – 171; S 156 of the UK Insolvency Act.

³⁴⁸ Keay *et al* 2001 *Int. Insolv. Rev.* 170 – 171; S 156 of the UK Insolvency Act.

³⁴⁹ Keay *et al* 2001 *Int. Insolv. Rev.* 170 – 171.

³⁵⁰ Section 115 provides for the payment of costs in voluntary winding-up proceedings. The provision reads as follows: "after the payment of any liabilities to which section 174A applies, all expenses properly incurred in the winding up, including the remuneration of the liquidator, are payable out of the company's assets in priority to all other claims." This demonstrates the preference assigned to winding-up expenses.

³⁵¹ Rule 3.50 of the 2016 UK Insolvency Rules; Keay *et al* 2001 *Int. Insolv. Rev.* 171; Goode (2011) 261.

³⁵² Rules 6.42 and 7.108 of the 2016 UK Insolvency Rules; Rule 4.218 of the 1986 UK Insolvency Rules; Keay *et al* 2001 *Int. Insolv. Rev.* 171; Goode (2011) 261; Lynch-Fannon and Murphy *Corporate Insolvency and Rescue* (2016) 292.

winding-up by the court.³⁵³ As indicated, such priority can be restructured by a court, should there be insufficient assets to offset liquidation expenditure.³⁵⁴ In other words, a court may deviate from the prescribed order of preference, if the circumstances permit it. This discretionary power is derived from section 156 of the UK Insolvency Act, which specifies that:

“The court may, in the event of the assets being insufficient to satisfy the liabilities, make an order as to the payment out of the assets of the expenses incurred in the winding up in such order of priority as the court thinks just” (emphasis added).³⁵⁵

The wording alludes to a wide discretionary function, in which the court will enjoy a seemingly “unfettered” ability to depart from the prescribed order of preference.³⁵⁶ However, such discretion does not permit courts to assign preference to external costs, which fall outside the ambit of these provisions. As affirmation, Goode asserts that “...apart from adjusting the order of priority, the court has no discretion as to the categories of expense that are payable as expenses of liquidation and is bound to treat as liquidation expenses all of the expenses listed in r.4.218 [rule 7.108].”³⁵⁷ Section 156 must further be read in conjunction with rule 7.110 (previously 4.220), which indorses the court’s discretion by stipulating that the order of priority is “subject to the power of the court to make orders under section 156, where the assets are insufficient to satisfy the liabilities” (emphasis added).³⁵⁸ Keay *et al* further advises that courts are reluctant to exercise this discretion and will not “readily” do so unless required.³⁵⁹ The inclusion of judicial discretion would provide South African courts with the requisite imprimatur to adjust the *pari passu* structure applied to the payment of preferential debts.³⁶⁰ In doing so, it could alleviate the burden imposed on creditors by elevating and/or demoting the preference assigned to various liquidation expenses. In practical terms, courts would be

³⁵³ Rules 6.42 and 7.108 of the 2016 UK Insolvency Rules.

³⁵⁴ S156 of the UK Insolvency Act; Keay *et al* 2001 *Int. Insolv. Rev.* 171; Goode (2011) 258.

³⁵⁵ S 156 of the UK Insolvency Act.

³⁵⁶ Keay *et al* 2001 *Int. Insolv. Rev.* 171.

³⁵⁷ Goode (2011) 258.

³⁵⁸ Rule 7.110 of the 2016 UK Rules; Rule 4.220 of the 1986 UK Insolvency Rules.

³⁵⁹ Keay *et al* 2001 *Int. Insolv. Rev.* 171.

³⁶⁰ Section 97(1)(c) of the Insolvency Act refers to the order of preference in which sequestration costs are to be paid. The provision indicates that the costs listed therein will “rank *pari passu and abate in equal proportions*”.

able to adjust the preference, thereby ensuring that the estate's assets are effectively used to reduce and/or defray expenses, which inflict a more onerous financial burden on creditors. Such discretion could potentially be modified to enable courts to waive or disregard certain sequestration costs, on grounds of insufficiency.

Interestingly, the remuneration of liquidators does not assume an elevated priority in UK bankruptcy law.³⁶¹ According to the order of preference, prescribed in rule 7.108, the remuneration of liquidators ranks below several other expenses.³⁶² The rationale for its low-ranking status is premised on the ability of liquidators to assess the financial capabilities of insolvent estates prior to accepting an appointment.³⁶³ Keay *et al* expounds on the position as follows:

“The law has taken the view that since the liquidator is in a position to know whether the assets will be sufficient, he or she can always refuse to proceed with the liquidation, unless remuneration is guaranteed by the creditors or contributories, the liquidator should not be entitled to high priority.”³⁶⁴

As such, the fees of liquidators will not be afforded a ‘super’ preference, especially where there are known deficiencies in the estate. UK liquidators are therefore expected to exercise a certain degree of diligence prior to accepting insolvency appointments. It is worth mentioning that the fees of liquidators previously assumed a higher ranking in earlier UK legislation.³⁶⁵ By demoting the priority of liquidators’ remuneration, the UK legislator has created an innovative deterrence mechanism, wherein liquidators will not be tempted to accept appointments in assetless estates. The importation of a similar demotion instrument, within South Africa’s insolvency structure, could promote the curtailment of exorbitant administrative fees. In addition, it may be prudent for the South African legislator to incorporate a ‘preliminary assessment provision’ that specifically requires trustees and liquidators to ascertain whether an insolvent estate possesses

³⁶¹ Keay *et al* 2001 *Int. Insolv. Rev.* 173.

³⁶² The remuneration of provisional liquidators is provided at Rule 7.108(4)(f), whilst the remuneration of final liquidators is found at Rule 7.108(4)(o).

³⁶³ Keay *et al* 2001 *Int. Insolv. Rev.* 173.

³⁶⁴ Keay *et al* 2001 *Int. Insolv. Rev.* 173.

³⁶⁵ Keay *et al* 2001 *Int. Insolv. Rev.* 173.

sufficient assets to defray their costs. If it appears, from a preliminary observation, that an estate lacks an adequate sufficiency of liquid assets or if it is reasonably foreseeable that the assets will be insufficient to cover his fees, a trustee/liquidator should be obliged to refuse an appointment in such an estate. This would pre-empt insolvency practitioners from incurring unnecessary costs and/or fees where there are insufficient assets to cover their fees.

As discussed above, the costs of liquidation are not considered a preferential debt for purposes of UK bankruptcy law. Instead, these costs form a separate category of expenditure that ranks above other preferential debts.³⁶⁶ Section 175 of the UK Insolvency Act dictates that after the payment of the winding-up expenses, “ordinary” and “secondary” preferential debts “shall rank equally among themselves and shall be paid in full, unless the assets are insufficient to meet them, in which case they will abate in equal proportions.”³⁶⁷ Notably, section 176ZA(1) of the UK Insolvency Act (relating to England and Wales) further provides that:

“The expenses of winding up in England and Wales, so far as the assets of the company available for payment of general creditors are insufficient to meet them, have priority over any claims to property comprised in or subject to any floating charge created by the company and shall be paid out of any such property accordingly.”³⁶⁸

It is evident from the foregoing, that winding-up costs are elevated above so-called ordinary and secondary preferential debts. By differentiating and/or superimposing liquidation costs, the UK legislator has ensured that these expenses are discharged before other preferential debts. Accordingly, the payment of liquidation costs is prioritized to circumvent possible future deficiencies. Whilst the South African insolvency system does afford preferential status to sequestration costs, in terms of section 97 of the Insolvency Act, it may be prudent for a separate category, which ranks in priority to other preferential debts, to be formulated.³⁶⁹ Additionally, the inclusion of a comprehensive order of priority could assist in differentiating which costs should be afforded greater

³⁶⁶ Keay *et al* 2001 *Int. Insolv. Rev.* 170 – 171.

³⁶⁷ S 175 of the UK Insolvency Act.

³⁶⁸ S 176ZA (1) of the UK Insolvency Act.

³⁶⁹ S 97 of the Insolvency Act.

preference. Finally, the inclusion of a discretionary component could serve as a beneficial method of redefining and/or limiting the scope of preferential debt. This would effectively reduce the ambit of costs to which creditors owe a reciprocal duty of contribution.

3.5 Conclusion

International bankruptcy policies provide inventive alternatives to creditor-funded insolvencies. These range from Germany's passive deterrence protocols to the UK's active state initiatives. These foreign insolvency systems envisage the defrayment of administrative costs without exacting adverse monetary contributions from creditors. The German perspective is characterized by stringent sufficiency requirements, which evade the institution of insolvency proceedings all together. Whilst this prevents assetless insolvencies, it has been severely criticized for its exclusionary nature and the risk of potential abuse and maladministration. The UK's system of official receivership exhibits an effective form of state administration which specifically caters for low asset estates. However, its reliance on cross-subsidization imposes a financial burden on creditors of "asset-rich" estates, who are required to subsidize the administration of 'poorer' NINA debtors. The extension of the Master's investigative capabilities, whilst theoretically sound, is not practically feasible given its prevailing limitations. Conversely, the importation of, *inter alia*, discharge, cost-deferral, early termination, socio-economic responsibilities and judicial discretion could serve as effective circumvention instruments, which deviate from South Africa's contributory system. As demonstrated, these policies and/or procedures would not only benefit South African creditors but could also be advantageous to debtors, by offering them the possibility of a 'fresh-start' through the discharge of their pre-sequestration debt.

Chapter 4: Digressing from the Contributory Paradigm of Creditor Contributions: the need for reformative intervention

4.1 Introduction

The emergence of creditor-funded insolvencies in South Africa predates the turn of the century, with historic records depicting diminished creditor returns coupled with high levels of contribution.³⁷⁰ In this respect, the South African insolvency law has continued to perpetuate a pro-liability paradigm, in which creditor contributions remain the sole *modus operandi* for funding the administration of assetless estates.³⁷¹ The preservation of a contributory model is manifest from both current and prospective legislative instruments, with the South African legislator exhibiting an unwavering adherence to the existing *status quo*.³⁷² It is widely accepted that South African bankruptcy procedure constitutes a “pro-creditor” construct, in which the primary objective is to secure an “equitable distribution of the debtor’s property to the advantage of his creditors.”³⁷³ To this end, it is submitted that the imposition of onerous financial obligations, in which creditors derive no pecuniary benefit and suffer further financial detriment, defeats the inherent purpose of the insolvency process.³⁷⁴

The term ‘creditor-funded insolvencies’ alludes to the exactment of statutory contributions from proven creditors in insolvent estates.³⁷⁵ This adverse form of creditor liability emanates from two overarching provisions of the Insolvency Act, being sections 89 and 106.³⁷⁶ In terms thereof, creditors are required to contribute towards deficits prevailing in the encumbered asset or free residue accounts.³⁷⁷ This obligation is contingent upon there being insufficient proceeds or free residue to offset, defray and/or settle the relevant costs.³⁷⁸ Creditors who have formally participated in the insolvency process, by proving

³⁷⁰ Chp 1 para 1.1.

³⁷¹ Chp 1 para 1.1.

³⁷² See Ss 89 and 106 of the Insolvency Act and S 99 of the Bill as discussed in Chp 2 paras 2.2 & 2.3.

³⁷³ Chp 1 para 1.2; Evans 2018 *De Jure* 300; Borraine *et al* 2015 *NIBLeJ* 61; Calitz 2008 *Obiter* 409.

³⁷⁴ Chp 1 para 1.2.

³⁷⁵ Chp 2 para 2.1.

³⁷⁶ See Ss 89 and 106 of the Insolvency Act as discussed in Chp 2 paras 2.2.1 & 2.2.6.

³⁷⁷ See Ss 89 and 106 of the Insolvency Act as discussed in Chp 2 paras 2.2.1 & 2.2.6.

³⁷⁸ Chp 2 paras 2.2 & 2.2.1.

claims against the estate, will attract a reciprocal duty to contribute in an amount proportional to the value of their claims.³⁷⁹ The apportionment of liability, amongst the *concursum*, is dependent upon certain hierarchical or preferential considerations, with different categories of creditors assuming varying degrees of liability.³⁸⁰ The costs of sequestration, giving rise to a contributory obligation, are canvassed in section 97 of the Insolvency Act and comprise of various charges, taxes, fees and remunerations, which are incumbent on the estate.³⁸¹

To mitigate the potential detriment suffered by creditors, the South African legislator has implemented a series of preemptive measures which include, *inter alia*, the advantage to creditors requirement, minimum asset prerequisites, statutory reporting standards, late proof provisions and the ability to rely solely on the proceeds of one's security.³⁸² Although commendable, such endeavors are either ineffective or omit a distinct circumvention component. Moreover, South Africa's current mitigation provisions, such as the advantage to creditors and minimum asset requirements, have been severely criticized for excluding debtors that possess insufficient assets (so-called no income no assets debtors).³⁸³ This has inevitably resulted in debtors being "too poor to go bankrupt" which, in turn, has exacerbated the detriment to both creditors and debtors alike.³⁸⁴ This has led to an unfortunate paradox, wherein debtors remain in a perpetual state of over indebtedness whilst creditors suffer severe financial prejudice. To address such irregularities, it is apparent that a *quid pro quo* between debtor and creditor interests must be obtained.³⁸⁵

As illustrated above, the German model of passive-deterrence proffers an intriguing insight into a collaborative arrangement, which 'balances' debtor and creditor interests by introducing a debtor-funded insolvency process incentivized by the appropriate discharge of pre-existing debt.³⁸⁶ On the converse, the UK has opted for a more active state-orientated approach, in which insolvencies are cross-subsidized through set

³⁷⁹ See S 106 of the Insolvency Act as discussed in Chp 2 para 2.2.9.

³⁸⁰ Chp 2 para 2.2.9.

³⁸¹ Chp 2 para 2.2.10.

³⁸² Chp 1 para 1.4 and Chp 2 paras 2.2.5, 2.2.4 & 2.2.8.

³⁸³ Chp 1 para 1.3; Coetzee & Roestoff 2013 *Int. Insolv Rev.* 2.

³⁸⁴ Chp 1 para 1.3; Rochelle 1996 *TSAR* 315.

³⁸⁵ Chp 1 para 1.5; *Discussion Paper 86* (1999) 9.

³⁸⁶ See S 4a of the German Insolvency Code as discussed in Chp 3 para 3.3.2.

administrative fees.³⁸⁷ This is further supplemented by the exercise of judicial discretion in the restructuring of preferential debt.³⁸⁸ The current discourse has sought to ascertain whether the aforesaid Eurocentric systems provide viable alternatives to South Africa's contributory framework. In doing so, it has endeavored to identify specific aspects of foreign policy which alleviate the necessity of creditor contributions through a combination of different funding and avoidance techniques.

4.2 Recommendations

4.2.1 *Lessons from Germany: the Three 'Ds': Discharge, Deferral and Discontinuation.*

The formation of an independent discharge procedure, coupled with a cost-deferral mechanism, could prove a valuable addition to South Africa's insolvency law. As discussed, the German procedure enables debtors with insufficient assets to defer payment of administrative costs pending a discharge of their prehistoric debt.³⁸⁹ Interestingly, this further incorporates a socio-economic element, which requires debtors to, *inter alia*, seek and procure gainful employment.³⁹⁰ A portion of the debtor's non-exempt income can thereafter be utilized to satisfy the claims of his creditors and/or to defray administrative costs.³⁹¹ The aforesaid adheres to a so-called "earned fresh start" approach, which obliges debtors to actively participate in the reduction of their indebtedness.³⁹² Upon discharge, debtors are required to pay-back all deferred amounts in set monthly instalments.³⁹³ This envisages a debtor-funded arrangement, where the onus of financing the costs of administration are borne exclusively by debtors themselves.³⁹⁴ As such, creditors assume a more subordinate role and do not attract a reciprocal duty to contribute or "make good" existing deficiencies.³⁹⁵ This substantially curtails the exclusionary effect of the advantage to creditors or minimum asset requirements by accommodating so-called NINA debtors. Whilst this process has been

³⁸⁷ Chp 3 para 3.4.2; van Dijck & Gramatikov 2009 *TISCO Working Paper* 2-3.

³⁸⁸ See S 156 of the UK Insolvency Act as discussed in Chp 3 para 3.4.3.

³⁸⁹ See S 4a of the German Insolvency Code as discussed in Chp 3 para 3.3.2.

³⁹⁰ See Ss 287b and 295(1) of the German Insolvency Code as discussed in Chp 3 para 3.3.2.

³⁹¹ Chp 3 para 3.3.2; Braun 2006 *Ger. Law J* 61.

³⁹² Chp 3 para 3.3.2; Roestoff & Coetzee 2017 *CILSA* 269.

³⁹³ Chp 3 para 3.3.2; Braun 2006 *Ger. Law J* 61.

³⁹⁴ Chp 3 para 3.3.2.

³⁹⁵ See S 6 of the Insolvency Act as discussed in Chap 2 para 2.2.8 and Chp 3 para 3.3.3.

criticized for its long duration and complex structure, resulting in reduced returns to creditors, it does not detract from its reformative capabilities.³⁹⁶

The importation of a similar discharge procedure could therefore facilitate a more accessible debt relief mechanism, in which administrative costs are deferred and subsequently repaid by debtors through structured monthly instalments.³⁹⁷ This would naturally alleviate the burden imposed on the *concursum creditorum* through the reassignment of liability. Moreover, it would “impress” a greater sense of socio-economic responsibility on South African debtors, by requiring them to ‘earn’ the benefit of a discharge.³⁹⁸ However, in implementing a corresponding discharge procedure, lawmakers would need to take appropriate cognizance of South Africa’s specific economic climate and the numerous financial obstacles experienced by South African debtors.³⁹⁹ This would call for a more lenient approach, in which the employment capabilities and/or prospects of debtors are carefully construed in light of the prevailing economic circumstances.⁴⁰⁰ In summation, the introduction of a incentivized discharge procedure, which is entirely debtor-funded, would constitute an effective alternative to South Africa’s contributory model. This would essentially ‘contribute’ towards a more “balanced” insolvency regime by adducing a mutually beneficial method of circumventing creditor contributions.⁴⁰¹

A further pre-emptive measure, which could potentially supplement and/or bolster South Africa’s contemporary framework, is the inclusion of an early termination/discontinuation provision.⁴⁰² This would oblige South African courts and/or the Master to terminate sequestrations, where it is reasonably apparent that the assets are insufficient to fund the continued administration of the estate. As explained, the German bankruptcy system contains specific termination protocols, which require the courts to discontinue insolvency proceedings due to a lack of assets.⁴⁰³ It would therefore be prudent for the South African

³⁹⁶ Chp 3 para 3.3.2; Kilborn 2004 *Nw. J. Int’l L. & Bus.* 294; Heuer 2020 *Int Insolv Rev.* s55.

³⁹⁷ Chp 3 para 3.3.2.

³⁹⁸ Chp 3 para 3.3.2; Kilborn 2004 *Nw. J. Int’l L. & Bus.* 291; Roestoff & Coetzee 2017 *CILSA* 269.

³⁹⁹ Chp 3 para 3.3.2.

⁴⁰⁰ Chp 3 para 3.3.2.

⁴⁰¹ Chp 3 para 3.3.2; *Discussion Paper 86* (1999) 9.

⁴⁰² See S 207 of the German Insolvency Code as discussed in Chp 3 para 3.3.4.

⁴⁰³ See S 207(1) of the Insolvency Act as discussed in Chp 3 para 3.3.4.

legislator to formulate a similar provision for such purpose or, alternatively, to broaden the application of section 54 of the Insolvency Act. In effecting this, the Master would be conferred with a statutory obligation to petition for the setting aside of sequestration orders on the express grounds of insufficiency.⁴⁰⁴ In theory, this would significantly curtail the duration of futile sequestrations and prevent the incurrence of unnecessary expense.⁴⁰⁵ Naturally this would lessen the risk of contribution as administrative costs would be substantially reduced.

Pursuant to termination, it would be advisable for the legislator to implement a mandatory *moratorium*, during which debtors would be prevented from disposing of and/or dissipating their remaining assets in manner which could potentially prejudice their creditors or cause certain creditors to be preferred above others. This would require the registering of an interdict or *caveat* against the property of debtors upon formal termination of the sequestration proceedings. Similarly, creditors would be unable to pursue and enforce their individual claims against debtors, thus averting unfair and/or inequitable distribution of the debtor's estate. During this interim period, debtors could be afforded the opportunity to seek the requisite discharge of their prehistoric debt. The costs would therefore be deferred and later repaid on an incremental basis. Alternatively, an expedited process could be introduced, whereby distressed sequestrations could be converted to discharge proceedings by the Master or other affected parties upon formal application.

4.2.2 *Lessons from the UK: Judicial Restructuring and Preliminary Assessments*

A salient feature of the UK's state-orientated approach, is the ability of courts to restructure preferential debt.⁴⁰⁶ This discretionary function is reserved solely for instances of apparent shortfall or insufficiency.⁴⁰⁷ Essentially, courts are able to deviate from the prescribed order of preference by elevating and/or demoting certain expenses.⁴⁰⁸ The

⁴⁰⁴ See S 54 of the Insolvency Act as discussed in Chp 3 para 3.3.4.

⁴⁰⁵ Chp 3 para 3.3.4.

⁴⁰⁶ See S 156 of the UK Insolvency Act as discussed in Chp 3 para 3.4.3.

⁴⁰⁷ See S 156 of the UK Insolvency Act as discussed in Chp 3 para 3.4.3.

⁴⁰⁸ See S 156 of the UK Insolvency Act and Rules 6.42 and 7.108 of the 2016 UK Insolvency Rules as discussed in Chp 3 para 3.4.3.

exercise of a similar discretionary power, by South Africa's courts, could effectively alleviate the contributory obligations imposed on creditors, by ensuring that assets are used to effectively offset more onerous liabilities subsisting in the estate.⁴⁰⁹ It is submitted that such discretion could be appropriately modified and/or extended to enable courts to disallow, reduce or exclude certain costs, wholly or in part, on the express grounds of insufficiency.⁴¹⁰ This would further supplement the powers currently exercised by the Master and would create an additional safeguard for circumventing contributions.⁴¹¹ Moreover, the creation of a preferential order of administrative expenditure, which is both distinguishable and independent from other preferential debts, could assist in defining and limiting the scope of costs to which creditors are expected to contribute.⁴¹² This separate category of sequestration expenditure would rank above all other preferential debts and claims in the insolvent estate.

The refusal of UK liquidators/trustees to accept appointments, in estates devoid of sufficient assets, further demonstrates a useful circumvention method that could find parallel application in South Africa.⁴¹³ This would require trustees to conduct a preliminary assessment, immediately preceding and/or pursuant to their appointment, to ascertain whether estates contain sufficient assets or free residue to firstly offset their fees and secondly to defray the remaining costs of sequestration.⁴¹⁴ In the event of assets being insufficient, trustees would be obliged to refuse or terminate their appointment with immediate effect.⁴¹⁵ Upon refusal or termination of a trustee's mandate, such estate would ideally be administered by the Master, which would exercise a broader range of investigative functions similar to those performed by the official receiver in the UK.⁴¹⁶ Given the known limitations of the Master, it is unlikely that the conferment of additional functions and duties would result in a more efficient administrative process.⁴¹⁷ Accordingly, this constitutes a hypothetical concept rather than a practical reality. In such

409 Chp 3 para 3.4.3.

410 Chp 3 para 3.4.3.

411 Chp 2 para 2.2.10 and Chp 3 para 3.4.3.

412 Rules 6.42 and 7.108 of the 2016 UK Insolvency Rules as discussed in Chp 3 para 3.4.3.

413 Chp 3 para 3.4.3; Goode (2011) 160.

414 Chp 3 para 3.4.3; Goode (2011) 160.

415 Chp 3 para 3.4.3; Goode (2011) 160.

416 Chp 3 para 3.4.2.

417 Chp 3 para 3.4.2.

cases, it is suggested that trustees only be permitted to accept appointments, in assetless estates, on the strict condition that the costs be deferred and subsequently repaid by debtors in set monthly instalments. Alternatively, trustees could, upon refusing or terminating their appointment, cause debtors to be referred to debt counselors or other alternative debt relief forums. This would, in all likelihood, involve a petition to the court for the sequestration proceedings to be discontinued or set aside. In adjudicating over such matters, South Africa's courts would need to exercise a wide discretionary function, in which sequestrations would either be converted to discharge proceedings or referred to alternative debt relief forums depending on the applicable facts.

4.3 Conclusion

To enable South Africa to effectively digress from a contributory model and to avert the further proliferation of creditor-funded insolvencies, it is evident that reformative intervention is required. The international bankruptcy protocols espoused by Germany and the UK exhibit innovative circumvention measures, which could alleviate the contributory burden imposed on South African creditors. Such measures include, *inter alia*, the formation of a distinct discharge procedure, which incorporates the deferral and repayment of administrative costs by debtors themselves. The inclusion of premature termination protocols coupled with the widening of discretionary powers could also reduce the risk of contribution, through the elevation, demotion, reduction or disallowance of certain administrative costs. Finally, the introduction of preliminary assessments, which require trustees to refuse or terminate appointments in assetless estates, could foster increased reliance on alternative debt relief mechanisms. In this respect, the importation of foreign bankruptcy policies constitutes a mutually beneficial method of circumventing creditor-funded insolvencies in South Africa.

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