SOME THOUGHTS ON THE MEANING AND APPLICATION OF COMMERCIAL INSOLVENCY IN WINDING-UP PROCEEDINGS INVOLVING CONTINGENT CREDITORS

Absa Bank v Hammerle Group 2015 (5) SA 215 (SCA)

1 Introduction

The winding up of companies is dually governed by the Companies Act (71 of 2008, hereinafter "the Companies Act 2008") and the relevant provisions of the repealed Companies Act (61 of 1973, hereinafter "the Companies Act 1973"). Thus, the winding up of solvent companies is dealt with under the Companies Act 2008 (ss 79–81) while insolvent companies are still wound up under the Companies Act 1973 (ss 337–426). Accordingly, the Companies Act 2008 does not have specific provisions that deal with the winding up of insolvent companies. Nonetheless, the Companies Act 2008 has made transitional measures that enable chapter 14 of the Companies Act 1973 to continue to govern the winding up of insolvent companies (item 9(1) of Schedule 5 of the Companies Act 2008; see further Swart and Lombard "Winding up of Companies – Back to Basics *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd* 2014 (2) SA 518 (SCA)" 2015 *THRHR* 356 356). Despite these transitional measures, most provisions of chapter 14 of the Companies Act 1973 (ss 343; 344; 346 and 348–353) are only applicable to the winding up of solvent companies where it is necessary to give full meaning and/or effect to the provisions that govern the winding up of solvent companies under the Companies Act 2008 (ss 79–81; item 9(2) of Schedule 5; see further Locke "The Meaning of 'Solvent' for Purposes of Liquidation in terms of the Companies Act 71 of 2008: *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd* 2015 *SA Merc LJ* 153 153–154). This dual approach has at times given rise to the inconsistent application of the relevant provisions that deal with the winding up of both solvent and insolvent companies by the courts (*HBT Construction and Plant Hire CC v Uniplant Hire CC* 2012 (5) SA 197(FB); *Herman v Set-Mak Civils CC* 2013 (1) SA 386 (FB); *Standard Bank of South Africa Ltd v R-Bay Logistics CC* 2013 (2) SA 295 (KZD); *First Rand Bank Ltd v Lodhi 5 Properties Investment CC* 2013 (3) SA 212 (GNP); see further Locke 2015 *SA Merc LJ* 153–154). Such inconsistencies are exacerbated by the different approaches that are confusingly employed by the courts, especially, in winding-up proceedings involving contingent creditors of persons that are commercially and/or factually insolvent. To this end, the recent decision in *Absa Bank v Hammerle Group* (2015 (5) SA 215 (SCA), hereinafter the

"*Hammerle Group* case") has usefully exposed some of the challenges encountered by the courts when enforcing winding-up proceedings involving contingent creditors and commercially insolvent persons in South Africa. This judgment is crucial because it has satisfactorily addressed the following concerns: (a) whether contingent creditors have *locus standi* to apply for the winding up of their insolvent debtors; (b) whether mere subordination of a contingent creditor's owed debt to the debts of other creditors of the same debtor could render it undue and not payable in winding-up proceedings; (c) whether contingent creditors are entitled to institute winding-up proceedings on the basis of the debtor's commercial insolvency; (d) whether statements made without prejudice during *bona fide* negotiations for the settlement of disputes are inadmissible in winding-up proceedings; (e) whether the debtor's unequivocal acknowledgement of its indebtedness to the creditor could interrupt the running of prescription in respect of the debt owed to that creditor; and (f) whether a debtor's debt restructure could constitute an act of insolvency (*Hammerle Group* case *supra* par 1–19; *Absa Bank v Hammerle Group* (7457/13) 2013 (court *a quo* par 1–46)). Accordingly, the article discusses these concerns in light of the *Hammerle Group* case judgment. This is done to explore whether contingent creditors' rights with regard to commercial insolvency winding-up proceedings are consistently recognised by the relevant courts in South Africa. The article also examines whether such rights are adequately protected under chapter 14 of the Companies Act 1973.

2 Overview of the facts

Absa Bank Limited (appellant) and Uwe Christian Hammerle (respondent) concluded a loan agreement on 6 December 2007 (loan agreement). Thereafter, the appellant advanced a loan of R4 million plus interest in order to finance the respondent and its business. In this regard, the respondent was obliged to repay this loan in 60 instalments of R96 045.70 with effect from 1 January 2008. This loan agreement was secured by a Special and General Notarial Covering Bond (bond) which was registered by the Registrar of Deeds in favour of the appellant on 13 December 2007. Accordingly, the respondent bound some of its movable property as security for its debt obligations to the appellant (see clause 2 of the bond; *Hammerle Group* case *supra* par 2; court *a quo* par 3–6). Moreover, on 19 November 2007, the appellant, Mfiso Investments (Pty) Limited and the respondent concluded a subscription and shareholders agreement (subscription agreement). Under this agreement, the appellant loaned R10 million to the respondent for the purposes of funding the acquisition of its business and assets. Consequently, the appellant became a minority shareholder in the respondent's business. The respondent was required to repay the aforesaid subscription agreement loan in 60 equal monthly instalments consisting of the capital repayment amount and interest. This loan was repayable immediately in certain instances, for example, where the respondent breached any material term or condition of the subscription agreement (*Hammerle Group* case *supra* par 3; court *a quo* par 7). Notably, the subscription agreement loan was subordinated to the claims of other creditors of the respondent (court *a quo* par 7). The appellant also argued

that it advanced additional funds to the respondent under an overdraft facility (court *a quo* par 11).

On 31 May 2011, the appellant filed a founding affidavit alleging that the respondent owed it about R21 005 197.46. This amount comprised of: (a) R4 693 437.78 which was owed under the loan agreement and the notarial bond; and (b) R16 311 759.68 which was owed under the subscription agreement. Nonetheless, the respondent rejected these claims and argued that it was not indebted to the appellant because: (a) the appellant's claim under the loan agreement debt had prescribed; (b) the loan advanced to the respondent under the subscription agreement was subordinated in favour of other creditors of the respondent (clause 11.3.3 of the subscription agreement). In light of this, the respondent was allegedly indebted to other creditors for about R2 205 657.07. Consequently, the respondent argued that the amount claimed by the appellant was not due and payable (*Hammerle Group* case *supra* par 4; court *a quo* par 8–12). The court *a quo* ruled in favour of the respondent and rejected the appellant's application for winding up of the respondent (court *a quo* par 46). In response to this, the appellant sought and obtained the leave to appeal against the court *a quo* verdict in the Supreme Court of Appeal (SCA).

3 Overview of the court *a quo* judgment

The appellant instituted an application for the winding up of the respondent in terms of sections 344 and 345 of the Companies Act 1973. This application was primarily premised on the argument that the respondent was commercially insolvent and unable to pay its debts as stipulated in section 345 of the Companies Act 1973 (read with s 344(f); *Hammerle Group* case *supra* par 1; court *a quo* par 1). The court *a quo* also dealt with the parties' application to rectify their loan agreement. Furthermore, the court *a quo* dealt with the respondent's application to strike out certain paragraphs of the founding and replying affidavits (court *a quo* par 1; 20–46).

In respect of the appellant's application for the winding up of the respondent, the respondent denied that it was unable to pay its debts. The respondent argued further that the appellant's debt was not yet due and/or payable since it was subordinated to the debts of other creditors. On the other hand, the appellant maintained that there was *prima facie* proof that the respondent was unable to pay its debts since it defaulted to pay its monthly instalments in terms of the loan agreement, the overdraft facility and the subscription agreement (*Hammerle Group* case *supra* par 4; court *a quo* par 8–19). Nevertheless, Mabuse J held, *inter alia*, that the applicant's letter of demand as at 21 January 2010 which was served to the respondent in terms of section 345 of the Companies Act 1973 erroneously requested payment for the overdraft facility debt, which was already settled instead of the debt owed by the respondent under either the loan agreement or the subscription agreement (court *a quo* par 13). This could suggest that the court *a quo* held that the mere fact that the respondent defaulted to pay its instalments was not sufficient and conclusive proof of its commercial insolvency and/or inability to pay its debts as contemplated in section 345 of the Companies Act 1973 (read with s 344(f)). Mabuse J held further that the

applicant's subsequent letters of demand were erroneously focused on privileged and inadmissible evidence made in a letter by the respondent on its indebtedness to the applicant during *bona fide* negotiations between the parties (court *a quo* par 41–46).

The court *a quo* held that the source of the respondent's indebtedness to the applicant was from the loan agreement and not the notarial bond *per se*. Furthermore, the court *a quo* held that the notarial bond between the respondent and applicant was valid. The court *a quo* also stated that the notarial bond does not necessarily require the actual delivery of the movable property to the creditor in order for it to be valid (court *a quo* par 24–37). Nonetheless, Mabuse J held that the debt giving rise to the appellant's application had prescribed since its actual genesis was from the loan agreement (court *a quo* par 24–37; 46). Over and above, the court *a quo* decided that the debt owed to the applicant under the subscription agreement was not yet due and payable since it was subordinated in favour of other creditors of the respondent (in this regard, Mabuse J relied on *Exparte De Villiers NNO in Re Carbon Developments* 1993 (1) SA 493 (AD) par 504–505; *Absa Bank Limited v Hammerle Group (Pty) Limited* (14203/2010) 2010 par 12–13 (*Absa Bank Limited* case); see court *a quo* par 38–40). Mabuse J granted the parties' application for the rectification of their loan agreement (court *a quo* par 23 and 46). Mabuse J also granted the respondent's application to have certain paragraphs of the founding and replying affidavits struck out (thus, par 78–79 and annexure FA19 of founding affidavit and par 37.3 of the replying affidavit were struck out and rendered inadmissible; court *a quo* par 46). In a nutshell, the appellant's application for the winding up of the respondent on the basis of commercial insolvency and inability to pay its debts was dismissed with costs (court *a quo* par 46).

4 Synoptical analysis of the SCA judgment

Before I unpack the SCA judgment in *Hammerle Group* case, it is plausible to highlight the probable meaning of "commercial insolvency" and "contingent creditors" for the purposes of winding-up proceedings in South Africa. Commercial insolvency occurs where an individual, entity or company fails to pay its debts when they fall due despite the fact that its assets might still be exceeding its liabilities. Thus, commercial insolvency could be regarded as a state of illiquidity where a natural or juristic person is unable to pay its debts whenever they are lawfully claimed by the creditors of that person (Luiz and Van der Linde "Trading in Insolvent Circumstances **–** Its Relevance to Sections 311 and 424 of the Companies Act" 1993 *SA Merc LJ* 230 231–233; Boraine and Van Wyk "The Application of 'Repealed' Sections of the Companies Act 61 of 1973 to Liquidation Proceedings of Insolvent Companies" 2013 *De Jure* 644 650–663). The cash flow test is usually applied by the courts and other relevant authorities to determine commercial insolvency in South Africa (Deloitte and Touché "The Companies Act: When is a Company Financially Distressed and What Does it Mean?" 2014 *Southern Africa Accounting and Auditing* 1 3–4). On the other hand, actual or factual insolvency occurs when the liabilities of a natural or juristic person as fairly assessed, exceeds the value of its assets causing it to be unable to

pay all its debts. Notably, the aforesaid debts also include debts that might not have fallen due and/or subordinated debts of the relevant creditors (Luiz and Van der Linde 1993 *SA Merc LJ* 231; *Ex parte De Villiers NNO in Re Carbon Developments supra* par 112B; 114B; 502C–H; Wainer "The Insolvency Conundrum in the Companies Act" 2015 *The South African Law Journal* 509 514–517). Accordingly, the balance sheet test is employed by the courts and other relevant authorities to determine actual or factual insolvency in South Africa.

The term contingent could refer to something that is "likely", "possibly" or "dependent" upon a condition or the occurrence of an uncertain future event. Accordingly, a contingent creditor could be defined as a lender or creditor whose owed debt is dependent upon an uncertain future event or development and/or whose owed debt was subordinated to the debts of other creditors.

The *Hammerle Group* case judgment has provided useful guidelines on the protection of contingent creditors' rights in winding-up proceedings. This judgment explored the correct meaning and application of commercial insolvency in winding-up proceedings involving such creditors by the relevant courts. For instance, the SCA was obliged to determine whether contingent creditors have *locus standi* to apply for the winding up of their insolvent debtors. This follows the fact that the respondent had consistently rejected its indebtedness to the appellant citing that: (a) the appellant's claim under the loan agreement debt had prescribed; (b) the loan advanced to the respondent under the subscription agreement was not due and payable since it was subordinated in favour of other creditors of the respondent (*Hammerle Group* case *supra* par 4; court *a quo* pars 1–46). Accordingly, the appellant was required to establish the *locus standi* by proving to the court that the respondent was indebted to it a total amount not less than one hundred rand (s 345(1)(a)(i) of the Companies Act 1973). The appellant successfully complied with this requirement by documenting in its founding affidavit that the respondent was indebted to it about R21 005 197.46 under the loan agreement and the subscription agreement (*Hammerle Group* case *supra* par 4; court *a quo* par 18–19). The appellant was further required to prove that the respondent was unable to pay its debts and/or that its liabilities exceeded its assets before commencing any winding-up proceedings (court *a quo* pars 18–19; *Hammerle Group* case *supra* par 5–7). In this regard, the appellant instituted a letter of demand against the respondent and requested the payment in respect of the subscription agreement debt on 4 July 2011 in terms of section 345(1)(a)(i) of the Companies Act 1973 (*Hammerle Group* case *supra* par 8; court *a quo* par 38–40). In light of this, the SCA noted that the court *a quo* relied on the judgment in *Absa Bank Limited* case *supra* par 12–13, where Blieden J dismissed the appellant's application to wind up the respondent on the basis that its claim was not due and payable since it was subordinated to other creditors (*Hammerle Group* case *supra* par 5). A subordination of a debt or loan usually occurs as an agreement between the lender or creditor and the debtor. Under this agreement, a lender or creditor will consciously agree not to claim or accept payment from the debtor in respect of its owed debt until other creditors are paid or sufficient assets are raised by the debtor (Wainer 2015 *The South African Law Journal* 515–517). Thus, a lender or creditor of

a subordinated debt or loan remains a lawful creditor of the debtor despite the obvious fact that its owed debt might only be considered after other creditors' claims are settled. Consequently, the SCA correctly held that the appellant was a contingent creditor of the respondent in accordance with the Companies Act 1973 (s 346(1)(b) read with s 345(2); *Hammerle Group* case *supra* par 9). Accordingly, the appellant had *locus standi* to apply for the winding up of the respondent despite the subordination clause in the subscription agreement. In other words, the appellant, like any other creditor, was lawfully entitled to institute its claim against the respondent, regardless of the fact that the subordination clause had enabled other creditors' claims to rank above its own claim under the subscription agreement (Ajoodha "A Bad Penny Always Turns Up" 2016 *Without Prejudice* 38 38–40; *Premier Industries Ltd v African Dried Fruit Co (1950) Ltd* 1953 (3) SA 510 (C) par 513D–F). In this regard, the SCA correctly held that the court *a quo* erred by employing Blieden J's erroneous approach to reject the appellant's application to wind up the respondent on the basis that the debt under the subscription agreement was not yet due and payable because of the subordination clause (*Hammerle Group* case *supra* par 9).

Put differently, despite the respondent's arguments to the contrary, a subordinated debt remains a liability of the debtor although it might not be readily considered as equity. In this regard, I concur in part with Wainer (2015 *The South African Law Journal* 516), that the mere subordination of a creditor's owed debt does not automatically make the debtor solvent again. The insolvent debtor remains insolvent irrespective of any such subordination (*Exparte De Villiers NNO in Re Carbon Developments supra* par 112B; 114B; 502C–H; Luiz and Van der Linde 1993 *SA Merc LJ* 231–237). Thus, the mere subordination of the appellant's owed debt (as a contingent creditor) to the debts of other creditors of the respondent did not render it undue and/or unpayable in respect of the winding-up proceedings. In light of this, the court *a quo* erred to uphold the respondent's plea that the appellant had no *locus standi* to institute winding-up proceedings against it yet the counsel for the respondent conceded that the appellant was a contingent creditor of the respondent (*Hammerle Group* case *supra* par 6). The counsel for the respondent conceded further that the respondent was commercially insolvent and unable to pay its debts as stipulated under the Companies Act 1973 (s 345). Over and above, the fact that the respondent's counsel requested the SCA to grant a provisional winding up order in lieu of a final winding-up order could suggest that the respondent knew that the appellant had *locus standi* to institute such orders (*Hammerle Group* case *supra* par 6).

As indicated earlier (par 3 above), the appellant maintained that the respondent was unable to pay its debts and therefore, commercially insolvent. On the contrary, the respondent rejected this assertion notwithstanding the fact that it had initially admitted in its answering affidavits that it owed other creditors about R2 205 657.07. It appears that the respondent was merely rejecting its indebtedness to the appellant because the debt in question was contingent upon other creditors' debts. Consequently, the SCA had to decide whether contingent creditors are entitled to institute winding-up proceedings against their debtors on the basis of commercial insolvency (*Hammerle Group* case *supra* par 4; 7). In this

regard, the SCA correctly held that the court *a quo* (par 41–46) erred to uphold the respondent's plea and denial of its indebtedness to the appellant without receiving any evidence to prove that the debts of other creditors were being timeously settled (*Hammerle Group* case *supra* par 7). In other words, the fact that the respondent was indebted to other creditors and struggling to settle their debts was probably sufficient proof that it was commercially insolvent. Therefore, the appellant, like any other creditor, was entitled to apply for the winding up of the respondent on the grounds of its inability to pay the debts and/or commercial insolvency. Nonetheless, the court *a quo* (par 41–46) interpreted the provisions of sections 344(f) and 345 of the Companies Act 1973 as if they could only be utilised by creditors who proved actual or factual insolvency of their debtors.

The confusion surrounding the verdict of the court *a quo* regarding the winding up of the respondent on the basis of commercial insolvency is not very unique. Several courts have grappled with the continued application of chapter 14 of the Companies Act 1973 in winding-up proceedings of insolvent persons. For instance, some of the courts' judgments wrongly held that creditors could not solely rely on their debtor's inability to pay its debts to apply for the winding up of that debtor (*Platt v Umgamanzi Fishing (Pty) Ltd* [2012] ZAECPEHC 81 par 11–12; *HBT Construction and Plant Hire CC v Uniplant Hire CC supra* par 6; *Herman v Set-Mak Civils CC supra* par 16). It also appears that the courts have in some instances interpreted the continued application of chapter 14 of the Companies Act 1973 as if it could only be evoked after the failure of any proposed business rescue procedures (*HBT Construction and Plant Hire CC v Uniplant Hire CC supra* par 6 and 9; *Herman v Set-Mak Civils CC supra* par 16 and 28; Swart and Lombard 2015 *THRHR* 358–361). In this regard, I concur with Locke (2015 *SA Merc LJ* 154–162) who correctly argues that the court in *HBT Construction and Plant Hire CC v Uniplant Hire CC* (*supra* par 6–7) erred by interpreting section 345 of the Companies Act 1973 as if it required the affected creditors to prove actual or factual insolvency before they could apply for the winding up of their debtors. In this case, a close corporation was unable to pay its debts but the affected creditors could not prove to the court that it was factually insolvent. Consequently, the court erroneously held that it was not just and equitable to wind up a close corporation which was apparently solvent but unable to pay all its debts as contemplated in section 81(1)(c) of the Company Act 2008 (*HBT Construction and Plant Hire CC v Uniplant Hire CC supra* par 15; Locke 2015 *SA Merc LJ* 154–162). This approach and verdict was also employed in *Herman v Set-Mak Civils CC supra* par 28–29; Locke and Esser "Company Law and Stock Exchanges" 2013 *Annual Survey of South African Law* 286–288). Likewise, in *First Rand Bank Ltd v Lodhi 5 Properties Investment CC* (*supra* par 22–24), the respondents argued that the appellant creditors in the winding up of the close corporation were obliged to prove its factual insolvency before they could rely on chapter 14 of the Companies Act 1973. Nonetheless, the court correctly held that the transitional measures in item 9 of Schedule 5 of the Companies Act 2008 were not only applicable to the winding up of insolvent companies when factual insolvency is proved by the creditors (*First Rand Bank Ltd v Lodhi 5 Properties Investment CC supra* par 25–26; 35; the same approach was

followed in *Scania Finance Southern Africa (Pty) Ltd v Thomi-Gee Road Carriers CC* 2013 (2) SA 439 (FB) par 12–21).

The aforesaid conflicting judgments could have negatively influenced Mabuse J to erroneously reject the appellant's application to wind up the respondent on the grounds of its commercial insolvency (par 3 above; court *a quo* par 41–46). This court *a quo* verdict could have been exacerbated further by the fact that terms "solvent" and "insolvent" are not expressly defined in the Companies Act 2008 (*Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd* (936/12) [2013] ZASCA 173; *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd supra*; Deloitte and Touché 2014 *Southern Africa Accounting and Auditing* 3–4; Locke 2015 *SA Merc LJ* 154–162; Swart and Lombard 2015 *THRHR* 358–361; Nichha *Moving Towards a Unified Approach for the Winding up of Companies in View of the 'Repealed' Chapter 14 of the Companies Act 61 of 1973* (LLM dissertation, University of Pretoria 2015) 27–35). Some courts have, however, held that the terms "solvent" and "insolvent" must be interpreted in a sensible and business-like manner (*Absa Bank Ltd v Rhebokskloof (Pty) Ltd* 1993 (4) SA 436 (C) par 440F; *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) par 18). In the circumstances, the SCA in *Hammerle Group* case correctly held that the appellant had the right to liquidate the respondent on the basis of commercially insolvency (*Hammerle Group* case *supra* par 8–9). Moreover, it is abundantly clear that the provisions of sections 344(f) and 345 of the Companies Act 1973 do not require proof of factual insolvency before the affected creditors could wind up their commercially insolvent debtors. The appellant, like any other creditor, had an *ex debito iustitiae* right to wind up the respondent since it was: (a) unable to pay its debts; and (b) exposing all the affected creditors to further risks of non-payment of their debts by trading in insolvent circumstances (*Hammerle Group* case *supra* par 13; Swart and Lombard 2015 *THRHR* 358–361; Fourie "Limited Liability and Insolvent Trading" 1994 *Stell LR* 148 165–171). Thus, notwithstanding the fact that factual insolvency is a factor that could be considered by the courts to determine if a person is unable to pay its debts, it was not necessary for the appellant to prove that the respondent was factually insolvent before it can be wound up by the court. This follows the fact that factual insolvency has not been statutorily recognised as an independent ground for the winding up of insolvent persons in South Africa to date (*Rosenbach & Co (Pty) Ltd v Singh's Bazaars (Pty) Ltd* 1962 (4) SA 593 (D) par 597E–G; *Herman v Set-Mak Civils CC supra* par 15; *Scania Finance Southern Africa (Pty) Ltd v Thomi-Gee Road Carriers CC supra* par 16; Locke 2015 *SA Merc LJ* 159–160; Cassim, Cassim, Cassim, Jooste, Shev and Yeats *Contemporary Company Law* (2012) 919; Swart and Lombard 2015 *THRHR* 358–361).

On 5 July 2011, the respondent replied the appellant's letter of demand dated 4 July 2011 in respect of the subscription agreement debt and conceded that its business was struggling and would tender payment only if there were surplus funds available subject to the subordination clause. Thereafter, the appellant relied on this letter as proof that the respondent was unable to pay its debts and/or commercially insolvent (*Absa Bank Ltd v Rhebokskloof (Pty) Ltd supra*; *Redco (Pty) Ltd v Meyer* 1988 (4) SA 207 (E); court *a quo* par 41–42). On the contrary, the respondent challenged the

admissibility of the aforesaid letter on the basis that it was privileged and written with a *bona fide* view of settling the dispute in question (court *a quo* par 43). Subsequently, the court *a quo* (par 44–46) granted the respondent's plea and held that the letter was privileged and inadmissible evidence in respect of the winding-up proceedings. Consequently, the SCA had to decide whether statements made without prejudice during *bona fide* negotiations for the settlement of disputes are inadmissible in winding-up proceedings (*Hammerle Group* case *supra* par 8–14). In light of this, the SCA noted that statements that are made during negotiations between parties in a bid to settle their disputes are generally privileged from disclosure irrespective of whether or not such negotiations have been stipulated to be without prejudice (*Hammerle Group* case *supra* par 8). Nonetheless, the SCA held that the contents of the letter in question served as an unequivocal acknowledgement by the respondent that it was unable to pay its debts and commercially insolvent (*Hammerle Group* case *supra* par 8; 12). Accordingly, the SCA correctly held that there are exceptions to the general rule regarding statements that are stipulated to be without prejudice. For instance, where such statements constitute an offer or arrangement made by the debtor during negotiations with the creditor to be released from its debts (s 8(e) of the Insolvency Act 24 of 1936), they could be admissible in court as evidence of an act of insolvency on the part of that debtor. Put differently, the SCA correctly held that if the debtor admits to its insolvency in an offer or arrangement made with the creditor (as the respondent did in *Hammerle Group* case *supra*), public policy dictates that statements involving such admission must not be precluded from the sequestration or winding-up proceedings, even if they were made without prejudice or in confidence. Winding-up and insolvency proceedings usually involve the public interest and a *concursus creditorium* is created to protect the trading public from the risk of further dealing with a person trading in insolvent circumstances (*Absa Bank Ltd v Chopdat* 2000 (2) SA 1088 (W) par 1092H–1094F; *Lynn and Main Inc v Naidoo* 2006 (1) SA 59 (N) par 23–24 which, *inter alia*, held that a debtor's statements that concede or give rise to an act of insolvency during negotiations with creditors should not be afforded the same protection which the common-law privilege accords to other settlement negotiations). Moreover, the *court a quo* failed to note that all the unequivocal admissions of liability by the respondent were not made in the course of any negotiations but in response to the appellant's letter of demand in respect of the loan agreement debt. In this regard, the SCA correctly held that the court *a quo* erred by granting the respondent's application to strike out all references to its admissions of liability in the relevant answering letters (*Hammerle Group* case *supra* par 13–14; Ajoodha 2016 *Without Prejudice* 39).

This SCA verdict could further suggest that a debtor's proposed debt restructure constitutes an act of insolvency if the debtor admits its indebtedness and liability to the creditor in that debt restructure. Furthermore, it appears that for the purposes of sequestration and winding-up proceedings, such admission is treated as an act of insolvency even if it was made in the course of *bona fide* settlement negotiations between the debtor and the creditor (Ajoodha 2016 *Without Prejudice* 39-40; *Hammerle Group* case *supra* par 13–18). In light of this, I concur with Ajoodha (2016

Without Prejudice 38–40; *Hammerle Group* case *supra* par 11) who argues that the respondent's purported debt restructure proposal could have constituted an act of insolvency since it undeniably admitted its indebtedness to the appellant as follows:

> "our client has always indicated that it would like to make a settlement proposal... notwithstanding the aforesaid, please note that our client has been struggling to turn the business around. However, our client believes that it may in due course turn the business around by making it profitable. At this stage our client has not been able to make any meaningful profit in the business".

With regard to the respondent's plea that the appellant's claim in respect of the loan agreement had prescribed since a period of three years had lapsed (court *a quo* par 24–37), the SCA held that the court *a quo* erred by upholding the respondent's plea since it had unequivocally admitted its liability and indebtedness to the appellant (*Hammerle Group* case *supra* par 10–11; 15–18). This implies that the respondent's unequivocal acknowledgement of its indebtedness to the appellant in the letter of 24 June 2011 interrupted the running of prescription in respect of the loan agreement debt. In this regard, the court *a quo* overlooked the fact that the running of prescription is interrupted by any express or tacit acknowledgement of liability by the debtor (s 14(1) of the Prescription Act 68 of 1969; *Hammerle Group* case *supra* par 15–18).

Furthermore, the SCA held that the court *a quo* erroneously relied on cases (*Jhatam v Jhatam* 1958 (4) SA 36 (N) par 38C–G; *Santino Publishers CC v Waylite Marketing CC* 2010 (2) SA 53 (GSJ) par 58A–C) which were not applicable to the circumstances in *Hammerle Group* case (*supra*), to uphold the respondent's plea of prescription against the appellant's claim in respect of the loan agreement debt. For instance, in *Jhatam v Jhatam* (*supra* par 38C–G), the court did not grant an order for compulsory sequestration against the debtor because the petitioning creditor's claim was unenforceable since it had prescribed. Likewise, in *Santino Publishers CC v Waylite Marketing CC* (*supra* par 58A–C), the court held that both the appellant and the respondent had agreed that the appellant's claim had prescribed and therefore, there was no need for the court to grant a final order for the winding up of the respondent. Thus, unlike the position in *Jhatam v Jhatam* (*supra* par 38C–G) and *Santino Publishers CC v Waylite Marketing CC* (*supra* par 58A–C), the SCA in *Hammerle Group* case (*supra* par 16–17) correctly held that the appellant had the prerogative to institute winding-up proceedings against the respondent even though some of its claims were subordinated to the debts of other creditors. Accordingly, Mbha J was correct to: (a) set aside the initial order of the court *a quo*; (b) uphold the appellant's appeal with costs; and (c) grant the final order for the winding up of the respondent by the Master of the High Court (*Hammerle Group* case *supra* par 16–19).

5 Concluding remarks

As indicated above, *Hammerle Group* case (*supra*) has brought much-needed clarity on some aspects of the recognition of the contingent

creditors' rights in commercial insolvency-related winding-up proceedings in South Africa. It has satisfactorily indicated that the contingent creditors' rights with regard to the winding up of commercially insolvent natural or juristic persons are inconsistently recognised by the courts in South Africa. In this regard, it has further highlighted that such inconsistencies are compounded by the different approaches that are confusingly employed by the courts in winding-up proceedings involving contingent creditors of commercially insolvent persons. This confusion has been worsened by the divergent approaches that are followed by the courts when applying and interpreting the Companies Act 2008's transitional measures that enable chapter 14 of the Companies Act 1973 to continue to govern the winding up of insolvent companies (item 9 of Schedule 5 of the Companies Act 2008; see further par 4 above). In this regard, the SCA in *Hammerle Group* case (*supra*) has satisfactorily clarified that the contingent creditors, like any other creditor, have an *ex debito iustitiae* right to wind up their commercially insolvent debtors. It has also authoritatively provided that: (a) a lender or creditor of a subordinated debt or loan remains a lawful creditor of the debtor despite the fact that its owed debt is dependent upon the settlement of other creditors' claims; (b) the mere subordination of a contingent creditor's owed debt to the debts of other creditors does not necessarily render it undue and/or unpayable in litigation proceedings; (c) the provisions of sections 344(f) and 345 of the Companies Act 1973 do not require proof of factual insolvency before the affected creditors could wind up their commercially insolvent debtors; (d) a debtor's proposed debt restructure could constitute an act of insolvency if the debtor admits its indebtedness and liability to the creditor in that debt restructure; (e) if the debtor admits to its insolvency in an offer or settlement arrangement made with the creditor, public policy dictates that such admission must not be precluded from the sequestration and/or winding-up proceedings, even if it was made without prejudice or in confidence; and (f) the running of prescription is interrupted by any express or tacit acknowledgement of liability by the debtor (par 4 above).

Nonetheless, the SCA did not expressly provide practical guidelines on how the statements made without prejudice in insolvency proceedings could be admitted in the courts without discouraging the parties concerned from engaging in frank settlement negotiations on the basis that such statements could be used against them later. Moreover, it is submitted that the Companies Act 2008 should be amended to incorporate adequate and specific provisions that deal with the winding up of insolvent companies. In other words, the Companies Act 2008 should be amended to completely repeal the provisions of chapter 14 of the Companies Act 1973 in order to eradicate the confusion and inconsistencies associated with their application in winding-up proceedings. In conclusion, the SCA in *Hammerle Group* case (*supra*) failed to highlight the need for the legislature to consider introducing adequate definitions for the terms "solvent" and "insolvent" in the Companies Act 2008 in order to assist the courts and other relevant persons during the different stages of winding-up proceedings.

Howard Chitimira
North-West University, Mafikeng