SOUTH AFRICAN LAW COMMISSION

WORKING PAPER 39

PROJECT 63

REVIEW OF THE LAW OF INSOLVENCY

Rehabilitation

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INTRODUCTION

The South African Law Commission was established by the South African Law Commission Act, 1973 (Act 19 of 1973).

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PREFACE

This working paper has been prepared by the research staff of the Commission to serve as a basis for the Commission's deliberations. The points of view, conclusions and recommendations contained herein should not at this stage be regarded as the Commission's final points of view. The working paper is published in full to provide persons and bodies wishing to comment or make suggestions for the development, improvement, modernisation or reform of this particular branch of the law with sufficient background information to enable them to place substantiated submissions before the Commission.

Any request to treat comments or parts of comments on the working paper as confidential will be respected. If no request for confidentiality or anonymity is made, the Commission will assume that commentators agree to the Commission's quoting from or referring to comments and attributing comments to commentators.

Any person or body wishing to make oral representations to the Commission in addition to a written submission should submit to the Commission in writing a brief résumé of the proposed representations, together with a request to be heard by the Commission.

It would be appreciated if written comments, representations or requests could reach the Commission at the address given on the previous page by 15 June 1992.

The researcher responsible for the project, who may be contacted for further information, is Mr M F Palumbo. The project leader and chairman of the Project Committee is Mr G G Smit.

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1. INTRODUCTION

1.1 The entire law of insolvency is at present being reviewed by the Commission and a Project Committee was established for this purpose. Since the revision of the law of insolvency is a comprehensive task, the Project Committee decided to divide the investigation into subdivisions and to publish working papers for comment in respect of these subdivisions as and when the working papers are completed. To date four working papers have been distributed for comment:

(a) Prerequisites for and alternatives to sequestration (Working Paper 29).

(b) Qualifications, appointment and removal of liquidators (Working Paper 30).

(c) Effect of insolvency on assets, civil proceedings and contracts (Working Paper 33).

(d) Insolvency interdicts (Working Paper 35).

1.2 This is the fifth working paper on revision of the law of insolvency. The first three working papers are fairly complete and they contain a list of the topics that still require investigation. Comments on previous working papers revealed that respondents are interested in recommendations and not in a complete exposition of the legal position in other countries or the present legal position in South Africa. This working paper therefore concentrates on the problems experienced and proposals in this regard. In so far as this is relevant, reference is, however, made to the position in other countries.

2. THE PRESENT POSITION IN TERMS OF THE INSOLVENCY ACT 24 OF 1936 (HEREINAFTER REFERRED TO AS "THE ACT")

2.1 It is apposite to give a brief exposition of the relevant provisions of the Act dealing with rehabilitation. An application to the court for an order for rehabilitation may be made in any of the following circumstances:

(a) After acceptance of composition[1]

The application may be made after obtaining a certificate from the Master stating that the creditors have accepted a composition under which they are to receive at least fifty cents in the rand. Notice in the Gazette and to the trustee must be given.

(b) After the lapse of one, three or five years

If the insolvent is not entitled to apply as above, and provided that notice in the Gazette has been given to the Master and to the trustee, he may apply -

(i) after twelve months have elapsed from the confirmation by the Master of the first trustee's account in the estate, unless he falls within the provisions of either one of the following two paragraphs;[2] or

(ii) after three years have elapsed from the confirmation of the first account, if his estate has previously been sequestrated and if

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1 Sec 124(1).

2 Sec 124(2)(a).

he does not fall within the provisions of the following paragraph;[3] or

(iii) after five years have elapsed from the date of his conviction of any fraudulent act in relation to his existing or any previous insolvency or of any offence relating to the concealment or destruction of books or assets, the concealment of liabilities or pretext to the existence of assets, or failure to keep proper records.[4]

If the insolvent applies within four years of the date of sequestration he must further prove that the Master recommends that rehabilitation be granted.[5]

(c) If no claim has been proved against his estate and if his estate has not been previously sequestrated, and if he has not been convicted of any fraudulent act in relation to the existing insolvency or of any offence relating to the concealment or destruction of books or assets, the concealment of liabilities or pretext to the existence of assets, or failure to keep proper records, he may apply after the expiration of a period of six months from the date of sequestration. Notice in the Gazette must be given to the Master and to the trustee.[6]

(d) After the confirmation by the Master of a plan of distribution providing for the payment in full of all claims proved, together with interest, and of all the costs of sequestration, the insolvent may apply for his

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3 Sec 124(2)(b).

4 Sec 124(2)(c).

5 Sec 124(2).

6 Sec 124(3).

rehabilitation. Notice of the intended application must be given to the Master and the trustee.[7]

2.2 Any insolvent not rehabilitated by the court within a period of ten years from the date of sequestration of his estate, shall be deemed to be rehabilitated after the expiry of that period unless a court upon application by an interested person after notice to the insolvent orders otherwise prior to the expiration of the said period of ten years.[8]

2.3 The effect of an order of rehabilitation is to put an end to the sequestration; to discharge the insolvent from liability for all debts which were due or the cause of which had arisen before sequestration, save such as have arisen out of any fraud on his part; and to relieve him of every disability resulting from the sequestration.[9]

2.4 An insolvent in whose estate no creditors have proved claims[10] shall be reinvested with his estate on being rehabilitated.[11]

2.5 A rehabilitation does not affect, inter alia, the right of the trustee or creditors to any part of the insolvent's estate which is vested in but has not yet been distributed by the trustee.[12]

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7 Sec 124(5).

8 Sec 127A.

9 Sec 129(1).

10 See par 2.1(c) above.

11 Sec 129(2).

12 Sec 129(3)(c).

3. DISCUSSION OF COMMENTS AND PROVISIONAL RECOMMENDATIONS

Introduction

3.1 Comments received from individuals and institutions brought to light four problems with regard to rehabilitation. These relate to section 124(3) read with sections 129(2), 127A and 129(1)(b) of the Act, as well as a general objection that the provisions of the Act relating to rehabilitation are cumbersome.

Section 124(3) read with section 129(2) of the Act[13]

3.2 Under this section, after the expiration of a period of six months as from the sequestration of an estate, an insolvent may apply to the court for his rehabilitation if, inter alia, at the time of the making of the application, no claim has been proved against his estate. In practice, it is often the person who is hopelessly insolvent who, after six months, applies for his rehabilitation and is granted such on the ground that no claim has been proved against his estate. Because, on the face of it, the insolvent finds himself in a desperate financial position, his creditors are hesitant to prove a claim against his estate as they may be called upon to contribute towards the payment of the cost of sequestratation. They obviously first want to thoroughly satisfy themselves as to the actual financial position and possible assets of the insolvent. In the mean time, the six-month period expires, the insolvent applies for his rehabilitation which is granted and the creditors are left behind totally unsatisfied. Sometimes creditors are not even aware of such an application for rehabilitation. In this way the insolvent can free himself from all his creditors and turn over a new leaf.

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13 Comments received from Kolektor (Pty) Ltd, the Clearing Bankers Association of South Africa, the Master of the Supreme Court, Cape Town, and the Natal Chamber of Industries.

3.3 As Professor Smith[14] points out, section 124(3) can have anomalous results. This is succinctly illustrated by Mr Justice Hofmeyr in Ex parte Fernandez:[15]

> The literal interpretation of the sub-section (124(3)(b)) appears also to place a premium on the disregard by an insolvent of his creditors' interests, since the reason why claims are not proved against an insolvent estate is more often than not that the creditors fear that they may be called upon to pay a contribution towards the costs of sequestration, or that the prospects of a dividend are so remote that they do not appear to be worth the trouble of proving a claim ... It is clear that, in the case of an insolvent in whose estate there is only a slight shortfall, the creditors will not fail to prove their claims, while in the case of an insolvent in whose estate there are no or insignificant assets, the creditors are unlikely to prove any claims. If no claims are in fact proved in the last-mentioned estate, the insolvent who has shown least consideration for his creditors will be entitled to invoke the provisions of sec 124(3)(b), while the first-mentioned insolvent will not be allowed to claim the same privilege.

3.4 The only respondent that has endeavoured to offer a solution to the problem is Kolektor (Pty) Ltd. In their opinion it should either be made more difficult to apply for rehabilitation, or creditors should still be able to excuss concealed assets after rehabilitation. They argue that the answer lies in a combination of the two solutions. In the first place, notice of intention to apply for rehabilitation should not only be given to the trustee, but also to all known creditors. In this way "secret" rehabilitations would be countered. Moreover, creditors should be enabled to excuss concealed assets at any time before or after rehabilitation. Kolektor concedes that this would have the disadvantage of rehabilitation not completely relieving the insolvent of his previous problems. The basic principle, however, is that an insolvent should disclose all his assets to the advantage of creditors. Once the insolvent realises that rehabilitation will not help him to retain assets, the basic

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14 C Smith The Law of Insolvency Durban: Butterworths 1988 292.

15 1965 3 SA 726 (O) 728.

principle is reinforced and he will be less inclined to endeavour to conceal assets.

3.5 The first part of Kolektor's argument deals with notice of intention to apply for rehabilitation to all known creditors. The Act does not provide for the giving of notice of intention to apply for rehabilitation to creditors, and the notice in the Gazette constitutes the only notification to them. The insolvent is, however, obliged to give notice of his intention to apply for his rehabilitation to the trustee of his insolvent estate.[16]

3.6 There appears to be no objection against expecting the insolvent who wishes to be rehabilitated in terms of section 124(3) to give specific notice of his intention to his known creditors. In this notice (as well as in the notice to the Master and to the trustee, and the publication in the Gazette) the insolvent should also specify the assets of his insolvent estate. This would prevent creditors from unexpectedly being confronted with the rehabilitation of the insolvent while still investigating possible assets and would ensure that a creditor is offered the opportunity to oppose the grant of an application for rehabilitation.

3.7 The second part of Kolektor's argument deals with the excussion of concealed assets at any time before or after rehabilitation. The effect of the sequestration of the estate of an insolvent is, inter alia, to divest the insolvent of his estate and to vest it in the Master until a trustee has been appointed, and, upon the appointment of a trustee, to vest the estate in him.[17] Once an insolvent estate has vested in the trustee it remains so vested until the insolvent has become reinvested therewith in consequence of the acceptance of an offer of composition by his creditors or until rehabilitation.[18] It is

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16 Sec 124(1)-(3), (5).

17 Sec 20(1)(a) of the Act.

18 Sec 25(1) of the Act.

therefore clear that assets before or during sequestration vest in the Master or the trustee. Should such assets be revealed at any time before rehabilitation, a creditor would be able to prove a claim against the insolvent estate.

3.8 What is the position with concealed assets that are revealed only after rehabilitation? A rehabilitation order granted under the circumstances stipulated in section 124(3) of the Act has the effect of reinvesting the insolvent with his estate.[19] This would also be the position with concealed assets revealed after rehabilitation. Except for the possibility of being convicted of an offence under section 132 of the Act,[20] the insolvent would therefore be in a position to turn over a new leaf without any fear of the concealed assets being excussed by creditors.

3.9 Concerning rehabilitation orders granted under circumstances other than those described in section 124(3) of the Act, the proviso to section 25(1) states that any property which immediately before the rehabilitation is vested in the trustee shall remain vested in him after rehabilitation for the purposes of realisation and distribution. According to Mars[21] this also relates to property whose existence was unknown to the trustee. In terms of section 129(3)(c) of the Act a rehabilitation order shall not affect the right of the trustee or creditors to any part of the insolvent's estate which is vested in but has not yet been distributed by the trustee. This subsection, however, has in mind a right which has already vested and accordingly does not preserve the right to prove a claim nor the claim of an unproved creditor.[22]

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19 Sec 129(2) of the Act.

20 Concealing or destroying books or assets.

21 Mars The Law of Insolvency Eighth Edition by E de la Rey Cape Town: Juta 1988 175.

22 Brown v Oosthuizen 1980 2 SA 155 (O) 165.

3.10 It does not appear to be a viable solution to amend section 129(2) of the Act to the effect that the insolvent is not reinvested with his estate after rehabilitation, but that it remains vested in the trustee. It has been pointed out that the reason why creditors hesitate to prove any claims is that the insolvent, on the face of it, finds himself in a desperate financial position.[23] In the light of the decision in Brown v Oosthuizen,[24] these creditors will be prevented from proving a claim if significant concealed assets are revealed after rehabilitation, since they will not be proved creditors.

3.11 It appears that there are three solutions to the seemingly harsh effects on creditors of section 124(3) read with section 129(2) of the Act:

(a) Requiring the insolvent to give specific notice of his intention to apply for rehabilitation to his known creditors and to specify the assets of his insolvent estate in the said notice (as well as in the notice to the Master and to the trustee, and the publication in the Gazette).[25]

(b) Extending the six-month period in section 124(3) to a period of four years to correspond with the normal period of rehabilitation provided for in section 124(2).

(c) Amending section 129(2) to the effect that any part of the insolvent's estate which immediately before rehabilitation vested in the trustee shall, for the purpose of enabling unproved creditors to prove a claim in the insolvent estate, remain vested in the trustee for, say, a period of four years after rehabilitation.

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23 See par 3.2 - 3.3 supra.

24 1980 2 SA 155 (O).

25 See par 3.6 supra.

3.12 The Project Committee supports options (a) and (b). An insolvent in whose estate there are no or insignificant assets (with the result that creditors are unlikely to prove any claims) should not be in a better position than an insolvent in whose estate a dividend is available and against which claims are proved. In terms of section 54(5), if no trustee is elected or appointed, the Master or the insolvent with the Master's consent may apply to the court to set aside the sequestration. It would seem, however, that option (c) does not present a workable solution. The fact that no claim has been proved against an insolvent estate does not automatically imply that there is no surplus, nominal as it may be, in the insolvent estate. Section 116 of the Act provides that such surplus shall, after the rehabilitation of the insolvent, be paid out to him at his request. If such surplus were to remain vested in the trustee after the insolvent's rehabilitation, it would deprive the latter of the right accorded to him by section 116. The chances are that no concealed assets would be revealed after rehabilitation, with the result that claims would still not be proved. In these circumstances it would seem unfair to withhold any surplus from the insolvent.

3.13 A better solution would be to deal only with concealed assets which immediately before rehabilitation vested in the trustee. In other words, a rehabilitation granted on a section 124(3) application would still have the effect of reinvesting the insolvent with his estate, but concealed assets revealed after rehabilitation would remain vested in the trustee to enable unproved creditors to prove a claim in the insolvent estate. To give practical effect to this proposal, the Project Committee considers that the rehabilitated insolvent should not be reinvested with those assets not reflected in the statement of affairs contemplated in section 16(2)(b) or in the affidavit in support of the application for rehabilitation contemplated in section 126. The right of unproved creditors to share in the assets which the insolvent did not reveal to the Master or on

application for rehabilitation should not be affected by the rehabilitation of the insolvent.

Section 127A of the Act - Rehabilitation by effluxion of time

3.14 During a series of seminars on insolvency organised by the Association of Law Societies two firms of attorneys suggested that there should be better proof of the fact that an insolvent has been automatically rehabilitated after the expiry of the period of ten years. Reference was made to the seventh edition of Mars,[26] which casts doubt on the desirability of this automatic rehabilitation:

> It is in the interests of his creditors as well as the general public that the position of every insolvent is scrutinized by the court before the protective cloak of insolvency is removed.[27]

3.15 Professor Smith,[28] too, has doubts about section 127A of the Act:

> The wisdom of this innovation is to be doubted. An insolvent, whose status has been diminished by an order of the supreme court, should not be entitled to restoration to full status by mere passage of time. He should not be relieved of the necessity of making formal application to court with a full disclosure of his financial position so that the court can decide whether a rehabilitation order should be granted or not and if granted whether it should be conditional. It is important to remember that the question whether a person whose estate has been sequestrated should be rehabilitated affects not only that person but also his creditors and the general public who have an interest in whether the debtor should be revested with full rights to trade and obtain credit.

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26 Mars The Law of Insolvency in South Africa Seventh Edition by D F Waters & R D Jooste Cape Town: Juta 1980 460.

27 Mars The Law of Insolvency in South Africa Eighth Edition by E de la Rey Cape Town: Juta 1988 472 omits this criticism.

28 Smith 303.

3.16 In England a Review Committee was appointed to carry out an exhaustive reappraisal of all aspects of the insolvency laws of England and Wales. As regards rehabilitation, it is significant to note that in its final report[29] the Review Committee expresses similar reservations about automatic rehabilitation:

> We believe that the principle of automatic discharge ... would be inappropriate in Bankruptcy ... In Bankruptcy, the onus should always be on the bankrupt to apply for his discharge and to prove that this is warranted ... We believe that this is justified if Bankruptcy is reserved for those who merit it; in such serious cases we do not consider that an automatic discharge will be appropriate.

If a bankrupt has failed to make an application for discharge, the Committee recommends that there should be an automatic review by the court after five years from the date of the order declaring him bankrupt, for the purpose of determining whether he should be discharged.[30]

3.17 The English Insolvency Act, 1986,[31] however, does not reflect the above-mentioned recommendations. In fact, in the ordinary course of events a bankrupt is automatically discharged from bankruptcy by the expiration of merely two or three years.[32] The court may, however, order that the relevant period shall cease to run for a certain period, or until the fulfilment of certain conditions.[33]

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29 Report of the Review Committee Insolvency Law and Practice London: Her Majesty's Stationery Office 1982 par 607-610.

30 Ibid par 611.

31 1986 c 45.

32 Ibid sec 279(1)(b), (2).

33 Ibid sec 279(3).

3.18 The Scottish Law Commission[34] considers a situation of undischarged bankrupts to be undesirable. Acknowledging that the remedy lies in the bankrupt's own hands, it refers to the report of the Blagden Committee,[35] which states the following:

> It is so often the case that the more honest bankrupt does not apply for his discharge, owing either to ignorance of the procedure, to lack of funds to pay the small fees, or more often, to a desire to seek retirement and avoid any further publicity, with the result that he remains undischarged for many years often indeed for the remainder of his life.

3.19 In contrast with the views of the Review Committee referred to in paragraph 3.16 above, the Scottish Law Commission[36] favours the principle of automatic discharge:

> In our view, however, it would be desirable to fix a period after which, irrespective of action on his part, the bankrupt would normally be conceded a full and complete discharge. Whatever the conduct of the bankrupt prior to and during the course of the sequestration, his indefinite exclusion from the right to a discharge is not likely to benefit anyone. It seems harsh from the debtor's standpoint that the personal disabilities and disqualifications of a bankrupt should attach to him indefinitely. It is equally unsatisfactory from the standpoint of his post-sequestration creditors that the bankrupt should be shielded indefinitely from diligence on their part. It seems inappropriate, moreover, that the bankrupt's pre-sequestration creditors should retain indefinitely a right (which will usually not be exercised) to his post-sequestration estate. It would seem to be of advantage also to financial institutions to know that, after a specified period from the date of the sequestration, the bankrupt will normally be freed from restrictions on the obtaining of credit and no longer protected from diligence for debts contracted by him. ... We consider it would be simpler and more satisfactory to follow those systems which have enacted or proposed that the debtor should automatically receive a discharge by operation of law after the lapse of a specified period unless, on application and for cause shown, the court decides to defer that discharge.

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34 Scottish Law Commission (Scot Law Com No 68) Report on Bankruptcy and Related Aspects of Insolvency and Liquidation Edinburgh: Her Majesty's Stationery Office 1982 par 19.8.

35 Report of the Committee on Bankruptcy Law and Deeds of Arrangement Law Amendment (Chairman, Judge J B Blagden) (mnd 221 (1957)) par 55 quoted in ibid.

36 Scot Law Com par 913-914.

3.20 One of the reforms introduced by the Bankruptcy (Scotland) Act 1985[37] was the automatic discharge of the debtor after three years.[38] The trustee or any creditor can apply for a deferment of the discharge for a period not exceeding two years. Repeated applications for deferment are permitted.[39]

3.21 The Law Reform Commission of Australia[40] notes that, before the adoption of the Australian Bankruptcy Act, 1966,[41] discharge from bankruptcy could only be obtained by court order. Many bankrupts did not apply owing to ignorance of their rights, the cost of the proceedings, apprehension of the administrative complexities, fear of judicial proceedings, or simply through lack of assertiveness or motivation. They remained bankrupt, sometimes for decades.

3.22 The 1966 Bankruptcy Act, as amended, introduced some significant changes, inter alia:

(a) Automatic discharge is made possible after three years.[42]

(b) A bankrupt is not discharged from bankruptcy if he is still undischarged from an earlier bankruptcy; if he has again become bankrupt; if an objection (on specific grounds) to the discharge has been entered; or if an

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37 1985 c 66.

38 Ibid sec 54(1).

39 Ibid sec 54(3)-(9).

40 The Law Reform Commission General Insolvency Inquiry (Discussion Paper No 32) Sydney: Alken Press 1987 par 341-342.

41 No 33 of 1966.

42 Australian Bankruptcy Act 1966 sec 149(1).

order of the court is in force in relation to the bankrupt.[43]

(c) Objection to automatic discharge on the expiry of three years operates to extend the duration of bankruptcy to a maximum of five years, at which point automatic discharge would occur unless the court fixes another period.[44]

3.23 In the opinion of the Australian Law Reform Commission[45] the introduction of the concept of automatic discharge has undoubtedly been a great improvement.

3.24 Returning to the position in South Africa, section 127A of the Act stipulates, inter alia, that prior to the expiration of the period of ten years a court may, upon application by an interested person after notice to the insolvent, order otherwise (than rehabilitation by effluxion of time). One would assume that if section 127A really were problematic in practice, there would be numerous applications opposing automatic rehabilitation. The only known case, however, is referred to in De Polo v Dreyer.[46]

3.25 In comparison with the time periods required in the other legal systems discussed above, the period of ten years required by our law appears to be rather long. Interested persons therefore have adequate time to oppose automatic rehabilitation. If, during this period, no opposing applications are made, it would seem harsh from the insolvent's standpoint to indefinitely exclude him from the right to rehabilitation. In this regard the

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43 Ibid sec 149(3).

44 Ibid sec 149(7).

45 ALRC par 343.

46 1990 2 SA 290 (W) 293. A provisional trustee applied to court for the extension of the sequestration for a further period of six months. That order was granted in the Transvaal Provincial Division.

Project Committee identifies itself with the views expressed by the Scottish Law Commission.[47]

3.26 The Project Committee is of the opinion that section 127A of the Act should not be amended.

Section 129(1)(b) of the Act

3.27 Standard Bank (Card Division) argues that it is unfair to creditors of an insolvent that upon rehabilitation the insolvent is discharged from liability for all debts prior to sequestration where it may be impossible to prove fraud. It is especially concerned about so-called "consumer debts".

3.28 Reference is made to the United States Bankruptcy Code, which, according to the respondent's interpretation, provides that the following types of debt are not dischargeable:[48]

1. Consumer debt which accrued immediately prior to the debtor's bankruptcy (eg. purchases on a single credit card of luxury goods and services totalling more than $500,00 and made within forty (40) days of the purchaser's bankruptcy constitute non-dischargeable debts as do cash advances made within twenty (20) days of the bankruptcy and totalling more than $1 000,00 (if made on an open consumer credit plan)).

2. Debts incurred as a result of credit extended based on either false pretences and representations or a materially false financial statement furnished by the debtor.

3.29 The US Bankruptcy Code,[49] however, links consumer debts to fraudulently incurred obligations. The relevant sections read as follows:[50]

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47 See par 3.19 supra.

48 Quoting the respondent.

49 1978, 11 USC § 523(a)(2)(A), (C).

50 Ibid.

(a) A discharge ... does not discharge an individual debtor from any debt -

...

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by -

(A) false pretenses, a false representation, or actual fraud ...

...

(C) for purposes of subparagraph (A) of this paragraph, consumer debts owed by a single creditor and aggregating more than $500 for "luxury goods or services" incurred by an individual debtor on or within forty days before the order for relief under this title, or cash advances aggregating more than $1 000 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within twenty days before the order for relief under this title, are presumed to nondischargeable: "luxury goods or services" do not include goods or services reasonably acquired for the support or maintenance of the debtor or a dependent of the debtor; ...

A rebuttable presumption of <u>fraud</u> - that is, of nondischargeability - therefore arises from the debtor's incurring certain debts for luxuries or obtaining certain consumer loans shortly before his bankruptcy.

3.30 Under section 129(1)(b) of the Act debts that arose out of any fraud on the part of the insolvent are not discharged. The term "fraud" in this section probably bears the same meaning as when used in connection with the <u>actio Pauliana</u>,[51] i.e. not necessarily fraud in the criminal sense of the word. A rehabilitation also does not affect the liability of any person to pay any penalty or suffer any punishment under any provision of

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51 See Mars 233 - 234.

the Act.[52] This is also provided for in England,[53] Scotland[54] and Australia.[55]

3.31 Criticising the exemption of certain debts in Canada, a Canadian Study Committee[56] remarked as follows:

> In some cases, it may almost be regarded as a mockery of the bankruptcy system to take all the sizeable property of a debtor, distribute it among the creditors and then leave the debtor to cope with some of his largest creditors from whose debts he has not been released.

3.32 The Scottish Law Commission[57] echoes these sentiments:

> ... we are firmly persuaded than any obligations remaining after a bankrupt's discharge should be kept to a minimum, and consider that there should be no general right of exemption in respect of Crown debts. The bankrupt's discharge, however, should not affect his continuing liability to pay fines and other penalties due to the Crown ... Certain other obligations of the bankrupt should also subsist notwithstanding his discharge ... it should be expressly provided that the bankrupt's discharge does not release him from any liability resulting from fraud or breach of trust.

3.33 Since the equal treatment of creditors is the fundamental purpose of insolvency law, the Project Committee considers that this purpose would be thwarted if only certain debts of the insolvent, such as consumer debts, were not discharged. No debt should be accorded priority unless this can be justified by reference to principles of fairness and equity that would be likely to command general public acceptance. We are

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52 Sec 129(3)(e).

53 Insolvency Act 1986 sec 281(3), (4).

54 Bankruptcy (Scotland) Act 1985 sec 55(2)(a), (c).

55 Australian Bankruptcy Act 1966 sec 153(2)(b).

56 Report of the Study Committee on Bankruptcy and Insolvency Legislation Ottawa 1970 par 3.2.085 - 3.2.088 quoted in Scot Law Com par 19.23.

57 Scot Law Com par 19.23 - 19.24.

of the opinion that no such justification exists in relation to consumer debts.

3.34 If, however, the continuation of debts that arose out of fraud (not necessarily fraud in the criminal sense of the word) on the insolvent's part is justified, there should be no objection to extending this principle to offences stipulated in the Act. During a course presented by the Commercial Crime Unit of the South African Police, section 133 (concealment of liabilities or pretext to existence of assets), section 135(3)(a) (contracting debts without expectation of ability to pay) and section 137(a) (obtaining credit during insolvency without making known insolvency)[58] of the Act were mentioned for consideration. As a starting point, the Project Committee recommends that section 129(1)(b) of the Act be amended so as to (in addition to fraud) include sections 133, 135(3)(a) and 137(a) of the Act. Comment on this working paper might bring to light further offences that should be included.

3.35 At this point the Project Committee wishes to refer to an evidential question relating to -

(a) the fraud stipulation in section 129(b); and

(b) the proposed inclusion of sections 133, 135(a) and 137(a) in section 129(b).[59]

3.36 The decision of the English Court of Appeal in Hollington v Hewthorn[60] is the leading authority for the rule that a conviction in a criminal court is not admissible in subsequent civil proceedings as evidence that the accused committed the offence of which he was convicted. The rule has been the subject

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58 This would, of course, only crop up during a further sequestration.

59 See par 3.34 supra.

60 1943 KB 587; 1943 2 A11 ER 35.

of a great deal of criticism.[61] The Commission, however, has not accepted this criticism,[62] with the result that in South Africa there has been no direct statutory reform in this regard.

3.37 Convictions of fraud, sections 133, 135(a) and 137(a), in the context of paragraph 3.35 above, would therefore not be admissible in subsequent civil proceedings as evidence that the insolvent committed any of the offences in question. Creditors would themselves bear the burden of proving the necessary facts on a preponderance of probabilities. Creditors might consequently fail to recover debts from the rehabilitated insolvent.

3.38 There are examples in the Act of general legal rules that have been adapted to the prejudice of the insolvent:

(a) As a general rule a witness cannot be compelled to answer questions that might incriminate him. Section 32(2) of the Act creates an exception to this rule. It provides that in certain proceedings the insolvent may be compelled to give evidence on a subpoena issued on the application of any party to those proceedings or he may be called by the court to give evidence. When doing so he may not refuse to answer any question on the ground that the answer might tend to incriminate him or on the ground that he is to be tried on a criminal charge and may be prejudiced at such a trial by his answer.

(b) Under section 65(2) of the Act the law relating to privilege as applicable to a witness summoned to produce a book or document or giving evidence in a court of law applies to similar persons called at an interrogation under the Act,

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61 See C W H Schmidt Bewysreg Third Edition Durban: Butterworths 1989 552 - 553; L H Hoffmann and D Zeffertt The South African Law of Evidence Fourth Edition by D Zeffertt Durban: Butterworths 1988 94 - 96.

62 South African Law Commission Report on the Review of the Law of Evidence Pretoria: Government Printer 1986 par 18.5.

provided that the person interrogated is not entitled to refuse to answer any question on the grounds that the answer would tend to incriminate him. In the 1916 Insolvency Act only the insolvent was deprived of the right to refuse to answer incriminatory questions; in the present Act this deprivation has been extended to any person subjected to interrogation.

(c) Section 65(5) also expressly provides that any evidence given by a witness when interrogated at a meeting of creditors shall be admissible in any proceedings against the person who gave that evidence. Formerly admissions made by an insolvent when under examination at a meeting could not be used in evidence against him in a criminal case.[63]

3.39 The Project Committee is of the opinion that the interests of creditors should be met by providing that convictions on offences referred to in the context of paragraph 3.38 above are admissible in subsequent civil proceedings as evidence that the insolvent committed any of the offences in question.

The provisions of the Act relating to rehabilitation are cumbersome

3.40 In a memorandum prepared by one of the members of the Natal Law Society it is submitted that the provisions of the Act relating to rehabilitation are cumbersome. Insolvents convicted of offences arising out of their business transactions should be prevented from being rehabilitated for a fairly long time. However, those persons who are not convicted of such offences should be automatically rehabilitated after a period of not longer than three years. This would be in keeping with the trend in England and elsewhere[64] towards encouraging the rehabilitation of insolvent persons into the business community.

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63 Mars 492 fn 50.

64 See par 3.17, 3.20, 3.22 supra.

3.41 Two issues come to the fore, namely the concept of automatic rehabilitation and the lapse of different periods of time before an insolvent can be rehabilitated. Mention has already been made of the view that the position of every insolvent should be scrutinised by the court before a rehabilitation order is granted.[65] It has, however, also been established that it would seem harsh from the insolvent's standpoint to indefinitely exclude him from the right to rehabilitation.[66] Hence section 127A of the Act is supported in principle.

3.42 The question is whether the period of ten years for automatic rehabilitation required by our law should be brought into line with the trend in England, Scotland and Australia, where the expiration of merely two to three years is required. The Project Committee is of the opinion that interested persons should be given ample opportunity to ascertain the financial position of the insolvent and oppose automatic rehabilitation if necessary. If, during a period of ten years, no opposing applications are made, one could reasonably infer that automatic rehabilitation would not be prejudicial. The ten-year period provided for in section 127A is therefore not considered too long.

3.43 It follows that the Project Committee is not considering any amendment to either the principle of court scrutiny provided for in section 124 of the Act, or to the different periods of time provided for in section 124(2) (including the proviso) of the Act. The decision of Mr Justice Slomowitz in Kruger v The Master[67] is well-founded authority for this position:

> If one looks to the reason why, in s 124 (2), the Legislature saw fit to provide for the lapse of different periods of time before an insolvent could apply for his rehabilitation, the purpose behind the proviso to the section becomes manifest. It is sometimes forgotten that insolvency is not a crime, and

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65 Par 3.14-3.16 supra.

66 Par 3.18 et seq supra.

67 1982 1 SA 754 (W) 758.

the time periods set out in ss (a), (b) and (c), as well as the proviso itself, are not punishments. In a capitalistic society, the return for risk is profit but the pitfall is loss and possible insolvency. With the best will in the world, a man's business may fail. Nonetheless the taking of legitimate business risks is the very cornerstone of our system. Why then the imposition of the time period in question? The answer is not hard to find. Regrettably, dishonest or unduly speculative trading and the wanton incurring of credit without any reasonable expectation of repayment are often attendant upon insolvency. The purpose of rehabilitation is precisely what the word implies. In the words of Wessels J in *Ex parte Heydenreich* 1917 TPD 657 at 658:

> "I have to enquire whether the applicant is such a person as ought to be rehabilitated - is he a person who ought to be allowed to trade with the public on the same basis as any other honest man? That depends entirely on how he conducted his trade before he became insolvent. If he conducted it in a negligent manner, or so as to deceive others, he is not a person who ought to be rehabilitated until it is clear that he intends to adopt better methods. His rehabilitation ought to be withheld from him, or at any rate it ought to be postponed for such a time that he will receive a severe lesson as to the necessity of trading honestly."

This, in my judgment, is the true test to be applied in the exercise of a discretion whether or not to rehabilitate an insolvent and thus is the intention of the Legislature in specifying the time periods which it did in s 124 and the proviso thereto laid bare. It has seen fit to lay down the periods in question because it, in its wisdom, has decided that those are the times that must elapse before it can be said that a particular insolvent has, as it were, rehabilitated himself. On the other hand, it has at one and the same time taken account of the fact that a man may well be able to show that his business failed due to circumstances beyond his control and that he does not need the lesson of which Wessels J spoke. To this end it has given the Master and, if he consents, the Court, the power to reduce the period of four years referred to in the proviso. The Master must decide, having regard to the facts surrounding each insolvency, whether the particular applicant is a fit and proper person "to trade with the public on the same basis as any other honest man". In so deciding, he will take account of a host of matters, many of which will not be apparent to a Court, and he will arrive at his conclusion (if he exercises his powers properly) after considering not merely the information which the insolvent has put before him, but also his knowledge of the estate gleaned from his own records, what he has learned from the trustee, creditors and from other relevant sources. He will also have regard to his own general experience in matters of this nature. It is therefore clear that when making his recommendation he performs a function which a Court in the very nature of

things cannot fulfil: *Ex parte Isaacs* 1962 (4) SA 767 (W); *Ex parte Hittersay* 1974 (4) SA 326 (SWA).

4. SUMMARY OF RECOMMENDATIONS SUGGESTING AMENDMENTS

4.1 The Project Committee recommends that -

(a) section 124(3)(a) be amended so as to require of the insolvent also to give specific notice of his intention to apply for rehabilitation to his known creditors and to specify the assets of his insolvent estate in the said notice (as well as in the notice to the Master and to the trustee, and the publication in the Gazette);[68]

(b) section 124(3) be amended so as to extend the six-month period to a period of four years;[69]

(c) section 129(2) be amended so as to provide that the insolvent is not reinvested with those assets that are not reflected in the statement of affairs contemplated in section 16(2)(b) or in the affidavit in support of the application for rehabilitation contemplated in section 126;[70]

(d) section 129(1)(b) be amended so as to (in addition to fraud) include sections 133, 135(3)(a) and 137(a) of the Act;[71] and

(e) section 129 be amended so as to provide that a conviction on any offence referred to in section 129(1)(b)[72] is admissible in subsequent civil

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68 Par 3.11(a) supra.

69 Par 3.11(b) supra.

70 Par 3.13 supra.

71 Par 3.34 supra.

72 Fraud and the proposed inclusion of sections 133, 135(3)(a) and 137(a) of the Act.

proceedings as evidence that the insolvent committed the offence in question.[73]

73 Par 3.39 supra.

5. PROPOSED AMENDMENT CLAUSES

5.1 The following amendment clauses are envisaged to give effect to the above-mentioned recommendations:

GENERAL EXPLANATORY NOTE:

[ ] Words in bold type in square brackets indicate omissions from existing enactments.

_____ Words underlined with solid line indicate insertions in existing enactments.

Amendment of section 124 of Act 24 of 1936, as amended by section 32 of Act 16 of 1943 and section 41 of Act 99 of 1965

1. Section 124 of the Insolvency Act, 1936, is hereby amended-

(a) by the substitution for the words preceding paragraph (a) of subsection (3) of the following words:

"(3) After the expiration of a period of **[six months]** four years as from the sequestration of an estate, the insolvent concerned may apply to the court for his rehabilitation - ";and

(b) by the substitution for paragraph (a) of subsection (3) of the following paragraph:

"(a) if he has, not less than six weeks before making the application, given to the Master, **[and]** to the trustee, if any, and to the known creditors of his estate notice in writing, and published in the *Gazette* a notice of his intention to make the application, and furnished particulars of the assets, if any, of his insolvent estate in the said notices; and".

Amendment of section 129 of Act 24 of 1936

2. Section 129 of the Insolvency Act, 1936, is hereby amended-

(a) by the substitution for paragraph (b) of subsection (1) of the following paragraph:

"(b) of discharging all debts of the insolvent, which were due, or the cause of which had arisen, before the sequestration, and which did not arise out of any fraud on his part, or out of any offence under section 133, 135(3)(a) or 137(a);";

(b) by the substitution for subsection (2) of the following subsection:

"(2) A rehabilitation granted on an application made in circumstances described in section 124(3) shall have the effect of reinvesting the insolvent with **[his estate]** the assets reflected in the statement of affairs contemplated in section 16(2)(b) or in the affidavit in support of the application for rehabilitation contemplated in section 126, but shall not affect the right of the unproved creditors to any part of the insolvent's estate which remains vested in the trustee."; and

(c) by the addition of the following subsection:

"(4) A conviction on any offence referred to in subsection (1)(b) shall be admissible in subsequent civil proceedings as evidence that the insolvent committed the offence in question.".