THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

Reportable
CASE NO: 499/04

In the matter between :

THOMAS REGINALD CHOWLES HOSKING N.O.
RUDOLPH ERIC THOMAS HOSKING N.O.
PAUL MICHAEL HOSKING N.O. First Appellants
(In their capacities as trustees for the time being of Paragon Asset Management Trust)

THOMAS REGINALD CHOWLES HOSKING N.O.
RUDOLPH ERIC THOMAS HOSKING N.O.
PAUL MICHAEL HOSKING N.O. Second Appellants
(In their capacities as trustees for the time being of Paragon Asset Management Trust (Western Cape))

WILLIAM HENRY VOYSEY N.O.
COLLEEN VOYSEY N.O.
FREDERICK STEMMET N.O. Third Appellants
(In their capacities as trustees of the Commercial Investment Trust)

- and -

SAREL ALBERTUS COETZEE N.O.
JACOBUS MARTHINUS ABRAHAM LOUW N.O.
DOUGLAS JOHAN KLERCK N.O.
DAVID JOHN RENNIE N.O.
LESLIE NEIL SACKSTEIN N.O. First Respondents
(In their capacities as trustees in the insolvent estate of the Halgryn Family Trust)

THE MINISTER OF JUSTICE & CONSTITUTIONAL DEVELOPMENT N.O. Second Respondent

THE SOUTH AFRICAN LAW COMMISSION Third Respondent

Before: **HOWIE P, ZULMAN, CAMERON, NUGENT & PONNAN JJA**
Heard: **10 NOVEMBER 2005**
Delivered: **25 NOVEMBER 2005**
Summary: **Section 29(1) of the Insolvency Act 24 of 1936 – voidable preferences – whether unconstitutional.**

J U D G M E N T

NUGENT JANUGENT JA:

[1] A central feature of Anglo-American bankruptcy law for almost three centuries has been the principle of equitable distribution amongst concurrent creditors of the assets of the insolvent debtor. And following in the footsteps of that principle has been a perennial debate concerning the validity of dispositions that are made by an insolvent debtor before the axe of bankruptcy falls. For once an insolvent debtor disposes of property to one creditor the risk of loss to the others increases proportionately unless the debtor regains his solvency. The history of that debate and the ethical and commercial imperatives that have surrounded it are extensively explored in an erudite article by Professor Robert Weisberg entitled 'Commercial Morality, the Merchant Character, and the History of the Voidable Preference',[1] which places the debate in the following context:

> 'Preference law … reflects a kind of insecurity about the formal process of bankruptcy. Bankruptcy law enforces its principle of ratable distribution at the technical point when the petition is filed. But preference law then sets a still earlier moment at which the debtor's estate faces a risk of dismemberment. At that earlier moment, preference law imposes a duty or sanction on the debtor or individual creditor to preserve the estate so that, when the petition is filed, the trustee will still find the assets there to distribute. Bankruptcy law empowers the trustee and the court to enforce ratable distribution as a matter of public power; preference law implies that the debtor and creditor have a private duty to save the

[1] 39 Stanford LR Vol 3 (1986) 3.

bankruptcy process from becoming moot before it has a chance to start. It places on the debtor and individual creditor a social or moral responsibility to respect the interests of the general class of creditors, presumably in the name of the larger social goal of enhancing the efficient sale of credit.'

Professor Weisberg goes on to observe that 'despite apparent consensus on the purpose of preference law the conditions under which debtor and creditor owe this duty have been heavily contested for several centuries' and that the approach to be taken to preferences remains 'one of the most unstable categories of bankruptcy jurisprudence.'[2]

[2] Measures that aim at the impeachment of preferences are often founded upon what is considered to be the moral turpitude of an insolvent debtor who confers a preference on a creditor. But the impeachment of preferent dispositions can also be justified on grounds other than the moral turpitude of the debtor: on an obligation owed by creditors amongst themselves not to disturb the equitable distribution that they all are entitled to anticipate once a debtor is unable to pay all his debts.[3]

[3] The legislation in this country dealing with the problem of preferences reflects elements of both. It is reflected mainly in sections 29(1), 30(1) and 31(1) of the Insolvency Act 24 of 1936. Section 31(1) is aimed at collusive transactions that have the effect of prejudicing creditors or preferring one

[2] Weisberg, *op cit* 4.
[3] Weisberg, *op cit* 82-90.

creditor above another.[4] Section 30(1) is directed at dispositions that may not result from collusion but are nonetheless intended by the debtor to prefer one creditor above the others.[5] And no doubt because an insolvent debtor who disposes of property to a creditor shortly before sequestration can generally be presumed to intend to confer a preference s 29(1) allows for the impeachment of dispositions that are made less than six months before sequestration if they merely have the effect of conferring a preference unless the creditor can prove that that was not the debtor's intention and that it was made in the ordinary course of business. The section reads as follows:

' S. 29 **Voidable Preferences**

(1) Every disposition of his property made by a debtor not more than six months before the sequestration of his estate or, if he is deceased and his estate is insolvent, before his death, which has had the effect of preferring one of his creditors above another, may be set aside by the Court if immediately after the making of such disposition the liabilities of the debtor exceeded the value of his assets, unless the person in whose favour the disposition was made proves that the disposition was made in the ordinary course of business and that it was not intended thereby to prefer one creditor above another.'

[4] S. 31 **Collusive dealings before sequestration**

(1) After the sequestration of a debtor's estate the court may set aside any transaction entered into by the debtor before the sequestration, whereby he, in collusion with another person, disposed of property belonging to him in a manner which had the effect of prejudicing his creditors or of preferring one of his creditors above another.

[5] S. 30 **Undue preference to creditors**

(1) If a debtor made a disposition of his property at a time when his liabilities exceeded his assets, with the intention of preferring one of his creditors above another, and his estate is thereafter sequestrated, the court may set aside the disposition.

[4] The question in the present appeal is whether s 29(1) is constitutionally objectionable. The appellants contend that it is and they seek an order declaring it to be invalid. The circumstances in which the matter arose can be stated briefly. The appellants are the trustees of three trusts: Paragon Asset Management Trust ('Paragon'), Paragon Asset Management Trust (Western Cape) ('Paragon Western Cape'), and Commercial Investment Trust. Acting on behalf of hundreds of individual investors the trusts invested heavily in a business venture that was conducted by the Halgryn Family Trust. The investments were in the form of revolving loans that attracted a high rate of interest. Loans made by investors, with interest, were repaid for a while but the continuation of repayments was sustainable only with ever larger investments. Naturally the venture had a limited lifespan. Ultimately the Halgryn Family Trust was sequestrated leaving vast amounts incapable of being repaid.

[5] During the six months immediately preceding sequestration the trusts were periodically repaid with interest moneys that they had lent to the Halgryn Family Trust. According to the trustees of the insolvent estate (the first respondent) repayments to either Paragon or Paragon Western Cape or both amounted to R24 977 272 and repayments to Commercial Investment Trust amounted to R1 382 818. Relying upon the provisions of s 29(1) the trustees

of the insolvent estate sued the trusts in the South Eastern Cape High Court for recovery of the dispositions.

[6] The trusts excepted to the particulars of claim on the grounds that s 29(1) was constitutionally invalid. Presumably because that procedure is inappropriate for resolving an issue of that nature the action was stayed while the trusts brought an application for an order declaring that

'…section 29(1) of the Insolvency Act 24 of 1936 *insofar as it places an onus on a defendant to prove that a disposition was made in the ordinary course of business and that it was not intended thereby by the debtor to prefer one creditor above another* [is] inconsistent with the Constitution of the Republic of South Africa Act 108 of 1996 and [is] invalid.'

[7] The application was dismissed by the court below (Pillay AJ) in a lucid and well reasoned judgment and this appeal is brought with the leave of this court.

[8] As appears from the passage that I have highlighted the appellants' concern (at least initially) was that the onus that is cast upon a defendant who wishes to escape impeachment of a disposition is excessively onerous.[6] When asked to clarify what part of the section was said to be invalid the appellants' counsel at first asked for the deletion of the words 'not more than six months' and the words 'unless the person in whose favour the disposition was made

[6] What will be required to discharge that onus was considered by this court in *Cooper v Merchant Trade Finance Ltd* 2000 (3) SA 1009 (SCA) in which the more important earlier cases are collected.

proves that the disposition was made in the ordinary course of business and that it was not intended thereby to prefer one creditor above another'. But that only exposes the flaw in the case the appellant presented. The result of an order with that limited scope would expose to impeachment without qualification all dispositions made by an insolvent debtor at any time before sequestration with the effect of preferring one creditor above another. And if the impeachment of all such dispositions is constitutionally unassailable it can hardly be said that the qualifications are themselves objectionable. While it is true that an order in those terms would relieve a creditor of what is said to be an oppressive onus it would do so only by denying him any defence at all.

[9] Confronted with that difficulty the appellants' counsel grasped the nettle and plumped instead for an order declaring the whole of s 29(1) to be invalid. Although that was not the basis upon which the case was brought the appellants' change of tack does bring more clearly into focus the true nature of their complaint. What the appellants say, in effect, is that it is constitutionally impermissible to impeach a disposition unless it is shown to have been made by an insolvent debtor with the intention of conferring a preference. (Such a disposition is impeachable in terms of s 30(1)). Or viewed from the opposite perspective the appellants' argument is that it is constitutionally impermissible to impeach a disposition merely because it has the effect of conferring a

preference, which is what s 29(1) allows for in the absence of proof by the creditor that brings the qualification into effect.

[10] Why it should be objectionable to impeach a disposition that has the effect of conferring a preference was never fully articulated in argument. General appeals were made to the rights of dignity[7] and equality[8] that are protected by the Bill of Rights but those appeals were not developed. Nor am I able to see how any rights that are constitutionally protected might be compromised by s 29(1). Even an appeal to no more than considerations of commercial equity or fairness – if that were to be relevant – would not seem to me to assist the appellants. I have already pointed out that there is a sound commercial rationale for impeaching dispositions that confer a preference even where no moral turpitude attaches to the insolvent debtor. Indeed, as pointed out by Zulman JA in *Cooper,*[9] there are other jurisdictions that allow for the impeachment of dispositions by reason only of their effect and without any regard to the motive of the debtor.[10] Earlier I drew attention to the fact that what is equitable in this field of commercial activity seems destined to remain forever contested with the result that there will always be a variety of legitimate legislative choices. No reason has been shown why the legislative choice that is embodied in s 29(1) is constitutionally impermissible.

[7] Section 10.
[8] Section 9.
[9] Footnote 5.
[10] *Cooper*, at para 6.

[11] There is no merit in this appeal. The appeal is dismissed with costs including the costs of two counsel.

R.W. NUGENT
JUDGE OF APPEAL

HOWIE P)
ZULMAN JA)
CAMERON JA) CONCUR
PONNAN JA)