

Business Rescue, Restructuring & Insolvency

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SOUTH AFRICA

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The interplay between set-off and post-liquidation debt

Can a creditor that has realised its security in terms of section 83(3) of the Insolvency Act, 1936 claim set-off of a post-liquidation debt owed to it by an insolvent estate or company in liquidation against the amount of the proceeds of the realisation of the secured property that it is obliged to pay to the liquidator in terms of section 83(10) of the Insolvency Act? The High Court indicated that the answer is “No” and, *inter alia*, ordered the creditor to pay the amount of the net proceeds of the realised security to the joint liquidators. The interplay between set-off and post-liquidation debt was therefore considered by the Supreme Court of Appeal in *Emontic Investments (Pty) Ltd v Bothomley NO and Others* (1123/2022) [2024] ZASCA 1 (9 January 2024).

Before delving into the findings of *Emontic Investments*, a few general remarks are appropriate.

First, the legal principles regulating set-off are somewhat non-controversial and settled in South African law. They are that both debts must be: of the same nature; liquidated; fully due; and payable by and to the same persons.

Second, it is generally accepted that a lease agreement is not automatically terminated on the liquidation of a lessee. It is for the liquidator, in terms of section 37(2) of the

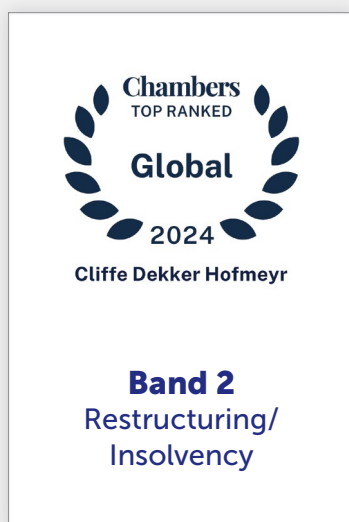
Insolvency Act, to notify the lessor, within three months of its appointment “that [they] desire to continue the lease on behalf of the estate”, otherwise “[they] shall be deemed to have determined the lease at the end of such three months”. If a liquidator does not give such notice, the company may well be liable to the lessor for administrative rental i.e. post-liquidation debt.

Third, a *concursum creditorum* is established with a liquidator that is entrusted with the estate’s assets, including the property rights and obligations of the insolvent or company. The liquidator is obliged to hold and administer the estate and distribute the proceeds among the competing creditors in the manner and order of preference specified in the Insolvency Act and the Companies Act, 1973. In essence, the hand of the law is laid upon the estate and no transaction can thereafter be entered into regarding estate matters by a single creditor to the prejudice of the general body of creditors. The claim of each creditor must be dealt with as it existed at the time of issue of the order. That is the fundamental purpose of insolvency legislation.

Fourth, and in regard to the realisation of securities, the starting point is found in section 82 of the Insolvency Act, which stipulates that, subject to the provisions of sections 83 and 90, the trustee of an insolvent estate shall sell all the property in that estate as directed by the creditors. The Insolvency Act contains detailed provisions prescribing the costs to which securities are subject i.e.

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the so-called “*section 89 costs*”. It further provides for the manner in which the proceeds of securities are to be applied; how the costs of sequestration are to be defrayed; when and how liquidation and distribution or contribution accounts are to be framed; the ranking of preferent and concurrent claims; the lodging of accounts with the Master of the High Court and the inspection and confirmation thereof; and the distribution of dividends.

Emontic Investments

It is against this background that the SCA, in *Emontic Investments* found that a creditor that has realised their security in terms of section 83(3) cannot claim set-off of a post-liquidation debt owed to them by an insolvent estate or company in liquidation against the amount of the proceeds of the realisation of the property that they are obliged to pay to the liquidator in terms of section 83(10). It found so for three reasons:

1. The explicit and unambiguous language of section 83(10), which states that “[w]hensoever a creditor has realized [their] security ... [they] shall promptly pay the trustee the net proceeds of the realisation to the trustee”, does not permit for set-off to operate against a liquidator’s claim for payment of the net proceeds of the realisation of their security by a creditor. A further consideration is that in terms section 124(4), a secured creditor of an insolvent estate that has realised their security in accordance with section 83 and has not remitted the proceeds of the realisation in accordance with the provisions of section 83(1) despite written demand is guilty of an offence.
2. Second, the obligation imposed on a creditor under section 83(10) to pay over the net proceeds of their realised security and the obligation of the liquidator to pay the creditor their preferent claim out of such proceeds, are not reciprocal obligations. The section imposes an obligation on the creditor to pay the liquidator the proceeds whenever they have realised their security. The creditor is entitled to receive payment out of the proceeds only “*thereafter*”, and only if certain requirements have been met. The amount owed to the creditor can therefore not be regarded as due and payable by the liquidator at that stage, as required for set off. It is not permissible for the creditor to require the liquidator to first offer payment of their claim.
3. Third, liquidators remain obliged to recover the proceeds from the sale of the property from the creditor. It is legally impermissible for the liquidators to agree that the creditor retain any portion of the proceeds of its realised security, on any basis.



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Set-off could not operate in the circumstances of the *Emontic Investments* case because its condition that both debts must be payable by and to the same persons was absent. According to section 37(3), the rent owed under the lease from the date the lessee's estate is liquidated until its determination or cession by the liquidator "*shall be included in the costs of sequestration*". The costs of sequestration are, in terms of section 97, to be defrayed from the free residue after the payment of any death-bed expenses. If the free residue is insufficient to cover the costs of sequestration, all creditors who have proved claims against the insolvent estate or company in liquidation, are obliged to pay for any shortfall in accordance with section 106.

Emontic Investments therefore serves as a useful reminder of the interplay between set-off and post-liquidation debt. Creditors and liquidators alike must therefore carefully consider the implications of executory contracts and lease agreements in any given scenario as well as the framing of the liquidation, distribution or contribution accounts.

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