BODY CORPORATE CANNOT SIT BACK AFTER SEQUESTRATING DEFAULTERS

FirstRand Bank Limited v Master of the High Court (Pretoria) and Others (1120/19) [2021] ZASCA 33 (7 April 2021)

When an insolvent company or individual's assets are sold to pay its debts, and it becomes apparent that the value of the assets is not enough to settle the administration costs of the insolvent estate, thus creating a shortfall in the estate, the creditors of that insolvent estate who proved claims against the estate will be held liable to contribute to the administration costs of the estate, pro rata according to the value of their claims. Here, where the body corporate brought the application, is it liable for costs in the administration of the insolvent estate or can it sit back being assured of receiving its outstanding levies when the property is subsequently transferred in terms of the provisions of the Sectional Titles Act?

The Judgment can be viewed here.

FACTS

The Victory Park Body Corporate ('the Body Corporate') had applied for the sequestration of one Mr Msimango. He was the owner of two sectional title units, one of which were within the Victory Park sectional title scheme. The one unit was bonded to Nedbank; the other was in a separate scheme and bonded to FirstRand Bank ('FRB').

Due to levy arrears and Mr Msimango's inability to pay his debts, the body corporate brought an application for the sequestration of Mr Msimango. The order was granted and subsequently, both properties were sold in execution after the sequestration order was handed down.

The trustees in the insolvent estate thereafter finalised the administration and submitted their First and Final Liquidation, Distribution and Contribution Account to the Master of the High Court, which office approved the account.

FRB noted an objection against the Master's approval of the account, on the basis that it was incorrect in the account to hold it and Nedbank, the two secured creditors, liable for the administration costs without reflecting the body corporate as being liable to pay any contribution at all.

The reason why the Body Corporate did not formally prove a claim in the insolvent estate, was because it relied on section 15B(3)*(a)*(i)*(aa)* of the Sectional Titles Act 95 of 1986, which requires that arrear levies had to be settled before transfer may be registered. Hence it taking a back seat after the order of insolvency was handed down.

Of note is that there were no concurrent creditors that proved any claims in this insolvent estate. There were only the two secured creditors who relied solely on the proceeds of their claims (and had no additional concurrent claims).

FRB's complaint was that bodies corporate could not simply petition for sequestration, recover outstanding monies in terms of section 15B(3)*(a)*(i)*(aa)* once a unit is sold, and then, when there is a shortfall in the free residue, leave it to other creditors who have proved their claims (including secured creditors who rely solely on their security) to bear the costs, including the costs paid by the petitioning creditor to their attorneys.

FRB's case was that, properly interpreted, the relevant sections of the Insolvency Act 34 of 1936 ('the Act') absolved it from liability for a cost contribution where it relied solely on the proceeds of its secured claim, i.e. where they had no additional concurrent claims. These sections are:

- section 14(3), which provides that in the event of a contribution by creditors under section 106, the petitioning

creditor, whether or not he has proved a claim against the estate ". . . shall be liable to contribute not less than he would have had to contribute if he had proved the claim stated in his petition";

- section 89(2), which provides that where creditors rely for the satisfaction of their claim solely on the proceeds of the property which constitutes their security, they shall not be liable for any costs of sequestration other than the costs specified in section 89(1), and costs for which they may be liable under paras *(a)* and *(b)* of the proviso to section 106; and

- section 106*(a)*, which provides that if all the creditors who have proved claims against the estate are secured creditors, who would not have ranked upon the surplus of the free residue if there were any, they shall be liable to make good the whole of the deficiency, each in proportion to the amount of his claim.

In the High Court, it was held that the Body Corporate, as petitioning creditor, was jointly liable, *pro rata*, for a cost contribution together with the two secured creditors who relied solely on their security, despite the Body Corporate not having proven a claim.

FRB appealed to the Supreme Court of Appeal as it argued that the full cost of administration should be carried by the Body Corporate in the circumstances of this matter where the secured creditors relied solely on their security, despite the Body Corporate not having proven a claim.

HELD

- A liability for cost contributions arises when the free residue in an insolvent estate is insufficient to cover the costs of sequestration.

- Section 106 of the Act provides the mechanism for determining which creditors must make a contribution towards the costs of sequestration, when there is no free residue or it is insufficient. It reads as follows:

- 'Where there is no free residue in an insolvent estate or when the free residue is insufficient to meet all the expenses, costs and charges, all creditors who have proved claims against the estate shall be liable to make good any deficiency, the non-preferent creditors each in proportion to the amount of his claim and the secured creditors each in proportion to the amount for which he would have ranked upon the surplus of the free residue, if there had been any: Provided that-

  (a) *if all the creditors who have proved claims against the estate are secured creditors who would not have ranked upon the surplus of the free residue, if there had been any, such creditors shall be liable to make good the whole of the deficiency, each in proportion to the amount of his claim;…"*

- The purpose of section 14(3) was to avoid a situation where a creditor would petition for the sequestration of the estate and not prove a claim, only for other creditors 'to pick up the costs'. That the section contains no exceptions means that the petitioning creditor must always contribute to shortfalls, whether or not it has proven a claim.

- Accordingly, section 106 applied to the petitioning creditor regardless of whether it had proved its claim.

- As to the position of secured creditors, the Court held that the section 106(a) proviso addressed only the situation where *all* creditors relied solely on their security (with no concurrent portions to their claims). That was not the case in the matter before it because the Body Corporate was not a secured creditor. Since the proviso did not apply, section 89(1) absolved FRB and Nedbank and the Body Corporate (as petitioning creditor) was solely liable to pay the costs of sequestration.

- Thus the correct approach to address the situation when there is no free residue or it was insufficient, is to first approach the petitioning creditor to contribute along with concurrent creditors who have proved their claims and secured creditors who would have ranked upon the surplus of the free residue. Only if there were no other proved and concurrent creditors (including the petitioning creditor) who could contribute, would the secured creditors who relied solely upon their security be called upon to pay.

CONCLUSION

The appeal succeeded.

Cape Town T: 021 406 9100
Claremont T: 021 673 4700
Fish Hoek T: 021 784 1580
Helderberg T: 021 850 6400
Blouberg T: 021 521 4000
Tyger Valley T: 021 943 3800
Illovo T: 011 219 6200
Fourways T: 010 001 2632
Centurion T: 012 001 1546
Bedfordview T: 011 453 0577
East London T: 043 721 1234