

# Considerations of a surety relying on the remedies provided in the Insolvency Act

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## CASE NOTE

### Introduction

- On 9 February 2024, the Supreme Court of Appeal in the case of *Cohen v Absa Bank Limited* [1] delivered a judgment in which it had to consider whether a surety could rely on the remedies provided section 31(2) of the Insolvency Act 24 of 1936 ("the Insolvency Act").
- Section 31(2) of the Insolvency Act states as follows

*"any person who was a party to a collusive disposition is liable to make good any loss thereby caused to the insolvent estate in question and shall pay for the benefit of the estate by way of penalty such sum as the court may adjudge, not exceeding the amount by which he would have benefited by such dealing if it had not been set aside; and if he is a creditor he shall also forfeit his claim against the estate"*

### Facts of the Case

- Cohen, had stood as surety for AMU in respect of a loan agreement concluded between Absa and AMU.
- As security for the loan, Absa registered a mortgage bond over the hotel and penthouses.
- AMU defaulted on its repayments and as a lifeline to AMU, Absa extended the deadlines for repayment and restructured the loan agreement on condition that *inter alia*, AMU would sell the penthouses and pay the proceeds to Absa.
- Despite the lifeline provided by Absa, AMU was unable to make payment of its debts, consequently, AMU was placed in liquidation.
- Absa lodged and proved a claim in AMU's insolvent estate.
- The liquidators of AMU published a second and final liquidation and distribution account ("L&D Account") evidencing a shortfall of R380 million to Absa.
- Pursuant to the publication of the L&D Account Absa instituted proceedings against Cohen based on the suretyship agreement executed by Cohen in favour of Absa.
- Cohen defended the action proceedings on the basis that the sale of the penthouses was a collusive disposition between Absa and AMU.

### Legal Issue

- The court had to determine whether a surety has the requisite *locus standi* to invoke the provisions of section 31(2) to avoid liability to a creditor after the primary debtor has been liquidated.

### Cohen's Argument

- Cohen argued that Absa's claim against AMU was forfeited as the sale of the penthouses constituted a collusive disposition which had the result of preferring one of AMU's creditors over the others which subsequently meant that Absa had forfeited its claim in terms of section 31(2).
- Cohen contended that his obligations to Absa in terms of the suretyship agreement had been extinguished.

### Absa's Argument

Absa argued *inter alia* that it was the only creditor that could have been reasonably affected by the sale of the penthouses as it held a mortgage bond over the penthouses which entitled it to the proceeds of the sale of the penthouses; furthermore, the restructuring of the loan agreement and sale of the penthouses was not for fraudulent purposes but rather to provide AMU with an opportunity to trade out of its financial distress.

### The Court's Decision

The court held that:

- section 31 is part of those provisions of Insolvency Act which address *inter alia* dispositions without value, undue preferences, collusive dealings and the procedures to be followed to set aside such improper dispositions.
  - the purpose of the disposition sections of the Insolvency Act is to empower a trustee or liquidator, to act against parties listed in those sections for the setting aside of improper dispositions and to obtain the remedies therein.
  - these remedies are only available to a liquidator or trustee who has secured an order setting aside the improper dispositions.
  - only a trustee or liquidator of the insolvent estate has *locus standi* to bring such proceedings unless the trustee or liquidator fails to do so in which case a creditor may bring the proceedings in the liquidator's or trustee's name subject to indemnifying the liquidator or trustee.
  - the default position where a liquidator, trustee or creditor fails to bring proceedings setting aside the improper disposition is that such disposition remains valid.
  - no liability or penalty can be imposed if the improper disposition is not set aside, consequently a creditor cannot forfeit its claim where the collusive disposition has not first been set aside.
- the Insolvency Act does not afford a shield to a surety who seeks to escape liability on the basis that the insolvent primary debtor colluded with a creditor prior to its liquidation in a manner set out in section 31. Only the liquidator and not a third party, such as a surety has *locus standi* to rely on the remedies provided in section 31.

### Conclusion

It is crucial to note that section 31(2) is only available to the liquidator or trustee (or a creditor in the case that the trustee or liquidator fails to act) in circumstances where the liquidator or trustee has first obtained an order setting aside the collusive disposition.

Where the collusive disposition has not been set aside, the remedies which flow from section 31(2) cannot be relied upon.

A third party such as a surety cannot invoke the provisions of section 31(2) to escape liability from its suretyship obligations. Accordingly, a surety can still be held liable where the primary debtor has gone into liquidation, unless the liquidator, trustee or creditor has obtained an order setting aside the collusive disposition and the creditor has forfeited its claim.

[1] [2024] ZASCA 16



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