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The termination of the duty and authority of a bank to honour its customer's cheques and other instructions for payment, including the broader implications for a bank of Sections 341(2) and 348 of the Companies Act 1973

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2015-01-19
http://hdl.handle.net/10539/16585

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If, in the example given, the other party was in fact liable for the damages, the effect of the compromise is that the other party is released from half his liability, and this release is, it is thought, an abandonment by the claimant of half its claim,(327) notwithstanding that the compromise may have been appropriate in the circumstances.(328)

If, on the other hand, the other party was not in fact liable for the damages, the effect of the compromise is that the other party undertakes a liability which he did not previously have and this undertaking is, it is thought, a disposition by that party as a contract for a payment if the Insolvency Act definition of 'disposition' applies but not if the definition does not apply.

(s) Variation and novation

If a right is varied by agreement the right may be diminished or enhanced. If it is diminished there may be a corresponding enhancement of an associated right or diminution of an associated obligation, or if it is enhanced there may be a corresponding diminution of an associated right or enhancement of an associated obligation.

If a right is diminished without a corresponding enhancement of an associated right or diminution of an associated obligation it is considered that a disposition clearly occurs by way of partial abandonment of the right.(329)

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(327) See the previous section.

(328) Sandé Restraints 1.1.3.26; 3.3.13; see also North West Construction Co (Pty) Ltd v Marian [1965] WAR 205 at 209(50) where the issue was raised but not decided.

(329) See 443-4 above.

What, however, is the position if there is an equal, or greater, corresponding enhancement of an associated right or diminution of an associated obligation? Must the position as a whole be looked at or must the effect of the variation on individual rights be looked at? The answer is, it is suggested, albeit with some diffidence, that the position as a whole must be looked at to determine whether the party's position as a whole has worsened or not.

True, the view has been taken[330] that it is not a relevant test in seeking to determine whether a disposition has occurred to examine whether or not there has been a change in the net asset position of the company. For example, if a supplier supplies goods to a company against payment in cash there is no change in the company's net asset position, but the payment is nevertheless a disposition. However, it is thought that this situation cannot be extended by analogy to the situation presently under discussion. In the case of the supply of goods one asset (cash) is entirely replaced by another (the goods), and the conclusion therefore seems inevitable that the cash has been disposed of. In the case of an agreement varying a right, on the other hand, it is suggested that all the associated rights and obligations are a single asset which *is changed, but not replaced; accordingly it does not* automatically follow that the right is disposed of.[331]

On the other hand, where a right is novated it is thought that there is a disposition. The right is extinguished and is replaced by a different right[332] and it follows, it is suggested, that the extinguished right has been dposed of by abandonment.

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(330) See 334-5 above.

(331) A similar question arises in a number of other contexts: see eg 371 above and 447-8 below.

(332) Swadif (Pty) Ltd v Dyke NO 1978(1) SA 928(A) at 940G; Kerr Contract 315-318.

If the effect of the variation of an agreement is to increase the company's obligations the agreement is a disposition if the Insolvency Act definition of 'disposition' applies provided that the contract is a contract for a sale, lease, mortgage, etc. Again it is thought that it is a party's overall net position that must be looked at, not the effect of the variation on individual obligations. If the Insolvency Act definition does not apply there is no disposition.

(t) Cancellation by agreement

Where a contract is cancelled by agreement the rights under the contract are clearly abandoned but, as in the case of variation dealt with in the preceding section, it is thought that the position as a whole must be looked at in seeking to determine whether or not a disposition has occurred within the meaning of s 341(2). On this approach, if the value of the rights abandoned exceeds the value of the corresponding obligations there is a disposition but not otherwise.

What is the position if payments have been made, or other property has been delivered, pursuant to the contract and which are to be repaid or redelivered pursuant to that cancellation? Will the repayment or redelivery be a disposition within the meaning of s 341(2)? The answer is, it is thought, in the affirmative. The company had ownership of, or the other real right in question in, the money or property and such ownership or other right is relinquished, ie disposed of, by the cancellation and repayment or redelivery. The position is quite different where the original contract is for a fixed period and the goods are redelivered at the end of the period eg the redelivery of the leased property at the end of a fixed period lease. Here the lessee's right to possession of the property merely expires; the lessee never had any greater right which is disposed of when the property is returned.

(u) Cancellation pursuant to a provision in the contract

If a party to a contract has the right to cancel the contract does a disposition occur if the party elects to do so? The party may have the right to cancel pursuant to a provision in the contract without the other party's have committed a breach of the contract or his right to cancel may arise from a breach of the contract by the other party. It is only the former situation that is dealt with in this section, the question of cancellation on breach being dealt with in the next section.

If a company has the right to cancel a contract the contract is subject to a resolutive condition which it is in the discretion of the company to fulfil or not. The position in regard to contracts has been considered above[333] and the view taken was that if the company elects to cancel the contract there is a disposition if the value of the rights lost exceeds the value of the corresponding obligations from which the company is released by the cancellation. The view was further taken that if any payment is to be refunded by the company, or any other property is to be returned by the company, pursuant to the cancellation, the refund or return is also a disposition.

If the other party has the right to cancel and elects to do so no disposition by the company occurs: the company's rights were at all times subject to the possibility that the other party would elect to cancel the contract and accordingly if the other party does so the company's rights merely expire and there is no disposition by the company within the meaning of s 341(2).

(v) Cancellation pursuant to a breach of the contract

If either party to a contract cancels the contract due to a

(333) See 370-3 above.

breach of the contract by the other party, does such cancellation constitute a disposition within the meaning of s 34(2) on the part of either the cancelling party or the defaulting party?

If the company cancels, the position is, it is considered, similar to the position where a contract is cancelled pursuant to a provision in the contract, as dealt with in the previous section, in that there is a disposition if the value of the rights lost exceeds the value of the corresponding obligations from which the company is released by the cancellation,(334) but the position differs from cancellation pursuant to a provision in the contract in that the cancelling party will generally have a claim for any damages it has suffered and it will therefore suffer no diminution in the net value of the contract ie no disposition will occur. Where, however, the cancelling party does not have a claim to its damages, or to some of them, there is a disposition eg if a penalty was stipulated for in the contract but the penalty is inadequate and a claim for damages is precluded by the Conventional Penalties Act.(335) If any payment is to be refunded by the company, or any other property is to be returned by the company, pursuant to the cancellation, the refund or return is also a disposition.

If the other party cancels it is not possible to draw as clear a parallel with cancellation pursuant to a provision in the contract. In the case of cancellation pursuant to a provision in the contract the rights were at all times subject to the possibility of

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(334) But cf Buettermann v United States 155 F2d 597 (CCA8, 1946) in which the Circuit Court of Appeals held, in a different context, that the cancellation by a landlord of a lease by reason of the tenant's default entails the relinquishment of the landlord's rights under the lease and that this is a disposition by the landlord despite the fact that in that case the landlord benefited by the cancellation in that the leased property had been improved by the tenant and the improvements were forfeited to the landlord.

(335) 15 of 1962.

cancellation, whereas in the case of cancellation on default the rights become subject to cancellation by reason of the company's breach of contract. The question to arise therefore is whether the company's breach of contract, whether by way of an act of commission or of omission, can be so said to be a disposition by the company of its rights under the contract within the meaning of s 341(2).

Direct authority on the point is lacking but a parallel can perhaps be drawn with the case of loss of rights by inaction, especially when, as will generally be the case, the breach consists of an act of omission, not commission. Loss of rights by inaction is dealt with in the next section and it will be seen that at common law if a person allowed rights to be lost by inaction he was regarded as having alienated them, and it follows, it is suggested, that it can be argued by analogy that if a person allows rights to be lost by breach of contract that he can likewise be said to have disposed of those rights. It may be doubted, however, whether the courts will be willing to place so extensive an interpretation on s 341(2). But if they do so, there will only be a disposition if the contract constituted a net asset and not a net liability.

Whether or not the return by the defaulting party of money paid or goods delivered constitute a disposition again depends on whether the courts hold that a loss of rights by breach of contract is a disposition.(336)

(w) Loss of rights by inaction - Prescription

The loss of rights by prescription was regarded in Roman and Roman-Dutch law as an alienation of those rights :

(336) But cf Berg v Nxumalo & Anor 1959 (2) SA 247 (N) at 249H-250A in which the return of a motor car to the seller pursuant to the cancellation of the sale on the purchaser's default was held to be a disposal to the seller within the meaning of s 19(2) of Ordinance 10 of 1937(N).

'The term "alienation" also includes usucaption,[337] for it is difficult to understand that he who permits property to be acquired by usucaption should not be considered to have alienated it. He, also, is said to alienate who loses servitudes by failing to make use of them.'[338]

However, it is suggested that the courts are unlikely to hold that s 341(2) avoids prescription. Prescription, both extinctive and acquisitive, is governed by the Prescription Act[339] which would taken precedence over s 341(2) in accordance with the principle that a specific statutory provision takes precedence over a general provision even where - as in the case of s 341(2) - the general provision appears in a later enactment.[340] Moreover, the object of the Prescription Act is to achieve certainty for the benefit of the alleged debtor in the case of extinctive prescription,[341] and the claimant to the property in the case of acquisitive prescription, and the extension of the scope of s 341(2) to override this object would, it is felt, be to go beyond what the legislature intended in enacting s 341(2).[342]

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(337) Usucapio was the Roman law term corresponding roughly to acquisitive prescription in modern law: Kaser Roman Law # 25(II) and (IV); Voet 41.3.1 ff.

(338) Digest 50.16.28. See also Sandé Restraints 1.1.3.34; Voet 42.8.16.

(339) 68 of 1969.

(340) See eg R v Gwantshu 1931 EDL 29 at 31; Steyn Uitleg 188-91.

(341) See eg Murray & Roberts Construction (Cape) (Pty) Ltd v Upington Municipality 1984(1) SA 571(A) at 578F.

(342) If the failure to take action to prevent prescription is deliberate with a view to preferring a creditor, the preference may be subject to impeachment under the actio Pauliana: Voet 42.8.15.

On the other hand, where rights are lost by other forms of inaction - eg by allowing proceedings for a good claim to be dismissed - it is suggested that a disposition does occur within the meaning of s 341(2).

(x) Failure to take up rights or avoid obligations

The failure to take up rights is not a disposition of those rights:

> 'Anyone who does not avail himself of the opportunity of acquiring property is not understood to alienate it; as for instance, one who abandons an estate or fails to make a choice within a certain prescribed time.'(343)

By the same token, the failure to avoid obligations - eg failure to give notice terminating an onerous contract such as a suretyship, or the failure to defend a groundless claim - would not be a disposition.(344)

(y) Options and rights of pre-emption

Options to borrow have been considered above(345) and similar principles apply to other options. The failure to exercise an option is also dealt with above.(346)

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(343) Digest 50.16.28. See also Sandé Restraints 1.1.3.33; Mitchell v CIR 48 F2d 697 (CCA2, 1931) at 699 in which the decision not to exercise an option was held, in a different context, not to be a disposition of the option.

(344) But cf Voet 42.8.15.

(345) See 396-7 above.

(346) See the previous section.

A right of pre-emption only confers on the holder the right to enforce a sale to him if the grantor decides to sell. The position is therefore analogous to a suspensive sale where it is in the discretion of both parties as to whether or not the condition is fulfilled.(347) Once the grantor decides to sell the right of pre-emption is, in effect, elevated to an option and where the grantee exercises this 'option' a contract of sale comes into existence. It follows, it is considered, that if the contract of sale is a disposition within the meaning of s 341(2), which depends on whether or not the Insolvency Act definition of 'disposition' applies to the section, the disposition by the grantor occurs when it makes its election and the disposition by the grantee occurs when it makes its election.(348)

(z) Division

According to Sandé(349) division is an alienation and it is considered that this is correct, at least in relation to division by agreement. While it is true that the parties' net positions are not changed, each party disposes of his undivided interest in portion of the property and acquires the other's undivided interest in a different portion. If the Insolvency Act definition of 'disposition' applies both the conclusion of the contract to divide and the division itself are dispositions, but if the definition does not apply only the division itself is a disposition. Division by order of court is subject to the principles set out below.(350)

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(347) See 361-7 above.

(348) See generally the authorities cited in 373-5 above dealing with options.

(349) Restraints 1.1.3.30.

(350) See 455-8 below.

(aa) Accessio, commixtio and specificatio

Ownership of property may also pass to another by accessio, commixtio and specificatio. Such transfer of ownership will, it is considered, constitutes a disposition within the meaning of s 341(2),[351] provided that if the view expressed above[352] is wrong that s 341(2) does not require the commission of an act by the company, a disposition will only occur within the meaning of s 341(2) where the accessio, commixtio or specificatio flows from an act on the part of the company which itself occurs after presentation of the winding-up application against the company. If the Insolvency Act definition of 'disposition' applies to s 341(2) both the conclusion of the contract, if any, for the transfer of ownership and the transfer itself are dispositions, but if the definition does not apply only the transfer is a disposition.

(bb) Attachment and execution

Any attachment or execution put in force against the estate or assets of a company after the commencement of the winding-up of the company is separately declared void in terms of s 359(1)(b) of the Companies Act.

The only question therefore is whether, if the attachment or execution would also be void under s 341(2), the court can validate the disposition by exercising the power conferred on it by s 341(2). The answer is, it is considered, in the negative. Even if the court

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(351) Burns NO v Adlam 1963 (3) SA 718 (D & CLD) at 719H-720A, but cf Estate Uys v Galleid 1922 CPD 280 at 283. See also Chandler v Burk 99 So 727 (SC Ala, 1924).

(352) See 356-61 above.

were to order that an attachment or execution is not to be void under s 341(2) it would remain void under s 359(1)(b).[353]

(cc) Other dispositions in compliance with an order of court

As has been pointed out in the previous section, attachments and executions are separately declared void in terms of s 359(1)(b) of the Companies Act, but the question remains as to whether a disposition can take place in compliance with an order of court without an attachment or execution being involved. If so, the disposition is not void in terms of s 359(1)(b) nor, if the Insolvency Act definition of 'disposition' applies, is it void under s 341(2), because the definition expressly excludes dispositions in compliance with orders of court. On the other hand, if the definition does not apply, the disposition falls, it is considered, within the scope of s 341(2) for the reasons set out below.

The expressions 'attachment' and 'execution' are most commonly used to refer to the process whereby a judgment debt sounding in money is enforced by the attachment and sale in execution of assets belonging to the judgment debtor, but they are no doubt wide enough to also include the process whereby a judgment for the delivery of property is enforced by the sheriff or messenger of court by attachment and handing to the judgment creditor of the property.

On the other hand, it is considered that no attachment or execution can be said to have taken place where the judgment debtor complies with the judgment against it before steps are taken to

(353) Cf Re Omnico Ltd (1976) 1 ACLR 381 (NSW) at 387(45)-389(35). Sande, it may be noted, considered an attachment and execution not to be prohibited by a restraint on alienation: Restraints 1.1.7.107. See also Codex 5.71.1.

enforce the judgment. For example, if a judgment debtor pays the judgment debt before issue of a writ of execution such payment is in compliance with an order of court although no attachment or execution has occurred. If, therefore, the Insolvency Act definition of 'disposition' applies, such payment is not a disposition within the meaning of s 341(2), nor is it an attachment or execution within the meaning of s 359(1)(b). It is therefore valid.

These principles are of particular importance in relation to notarial bonds. Such bonds confer a preference ranking just above concurrent creditors in respect of the proceeds of the mortgaged assets.(354) In other words the preference ranks below the preference enjoyed by all other preferent creditors. If, however, the mortgagee can convert its bond to a pledge by taking possession of the mortgaged assets, the mortgagee will be elevated to the position of a secured creditor and the mortgagee's preference in respect of the proceeds of the assets will rank above the claims of nearly all other preferent creditors.(355) Notarial bonds commonly contain a provision entitling the mortgagee to take possession of the mortgaged assets in the event of the mortgagor's default, and often the mortgagor is willing to hand over possession, usually in consideration of a promise of further financial support. However, the delivery of the assets to the mortgagee, thus elevating the mortgagee's rights to those of a pledgee, would be a disposition,(356) and to avoid this mortgagees commonly first seek

(354) Section 100 of the Insolvency Act read with s 342(1) of the Companies Act.

(355) See 417-20 above

(356) International Shipping Co (Pty) Ltd v Affinity (Pty) Ltd & Anor 1983(1) SA 79(C) at 84D-E and 85C-D; R v Kruger 1956 (2) SA 201 (A) at 206B.

an order of court authorising them to take possession.[357] If the mortgagor then delivers the mortgaged assets to the mortgagee it does so in compliance with the order of court and there is no disposition as defined in the Insolvency Act.[358]

If the Insolvency Act definition of 'disposition' does not apply, compliance by the company with the order of court will, it is considered, constitute a disposition within the meaning of s 341(2). The view has already been taken[359] that it is not necessary that a disposition should flow from an act on the part of the company in order to fall within the ambit of s 341(2); all that is required is that the company's property is in fact disposed of. Accordingly, it does not matter whether the company voluntarily complies with the judgment or whether the *deputy sheriff* attaches and sells property in execution without the company's concurrence.

A disposition made in compliance with an order of court granted by consent was held in Hockey NO v Rixom NO & Smith[360] to nevertheless be excluded from the Insolvency Act definition of

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(357) See eg the International Shipping case supra; Pietersburg Cold Storage Ltd v Cacaburas 1925 TPD 295.

(358) See the International Shipping case supra at 85D-E. The courts commonly add a rider to their orders, apparently with a view to avoiding this consequence, reading:

> 'The order is not to affect the rights of any liquidator, judicial manager or creditor of the respondent to set aside the dispositions of the respondent's assets in whole or in part, whether as a voidable disposition or under the Conventional Penalties Act or otherwise.'

(See eg the International Shipping case at 83E). However, it may be questioned whether this rider is effectual: once the disposition has taken place in compliance with an order of court it is not, it is thought, a disposition as defined in the Insolvency Act, and if this is correct the court cannot empower the liquidator to treat it as a disposition.

(359) See 356-61 above.

(360) 1939 SR 107 at 112.

'disposition' in the same way as a disposition made in compliance with any other order of court, but the correctness of the decision was doubted in Muller & Anor NNO v John Thompson Africa (Pty) Ltd & Anor,[361] at least where the consent is not the result of a bona fide compromise of the action, although the court found it unnecessary to decide the point.

(dd) Expropriation

An expropriation under the Expropriation Act[362] would not, it is considered, be void under s 341(2), not because a disposition is not involved - one is involved - but because the Expropriation Act would take precedence as the more specific enactment.[363]

The question of whether an expropriation is a disposal within the meaning of s 27(1)(d) of the Transvaal Townships and Town-planning Ordinance[364] was in issue in Cullinan Properties Ltd v Transvaal Board for the Development of Peri-Urban Areas[365] and Melamet J held that an expropriation is not such a disposal *because the section refers to a disposal 'by the owner' and* therefore an act by the owner is required which is absent in the case of expropriation. This case is dealt with above[366] in dealing with the significance of the words 'by any company' in s 341(2) and the conclusion reached there is that the reasoning applicable to s 27(1)(d) cannot be applied to s 341(2), and that in

(361) 1982 (2) SA 86(D & CLD) at 92A and H.

(362) 63 of 1975.

(363) See 451 above. See too Sandé Restraints 1.1.7.113

(364) 11 of 1931 (T).

(365) 1978 (1) SA 282(T) at 285H - 287B.

(366) See 357-8 above.

contrast to s 27(1)(d), s 341(2) does not require an act on the part of the company. However, if this view is incorrect an expropriation will not be a disposition within the meaning of s 341(2) for the additional reason that there is no act by the company.

(ee) Issue of shares

If a company holds shares in another company and the latter company issues shares to a third party for no or inadequate consideration, the value of the shareholder company's shares is diminished. Can such issue of shares be regarded as a disposition of the shareholder company's property?

The difficulty in seeking to apply s 341(2) to such an issue of shares lies in the fact that the section requires that the company's property be disposed of. When shares are issued for no or inadequate consideration the value of the existing shares is diminished but there is no direct transfer of any rights from the existing shareholders to the new shareholders. Can, then, a disposition of the existing shareholders' property be said to have taken place?

The answer is, it is thought, albeit with considerable diffidence, that there is a disposition of the shareholders' property, although this entails giving a very extensive interpretation - perhaps an unacceptably extensive interpretation - to s 341(2).

True, there is no direct transfer of any rights from the shareholders to the third party; however, the effect of the issue of shares is that the shareholders' interest in the company is diminished and the diminution accrues to the third party. For example, if a person owns 100 per cent of the shares of a company and causes an equal number of shares to be issued for no

consideration to a third party the shareholder's right to 100 per cent of the dividends declared by the company is reduced to 50 per cent and the third party becomes entitled to the other 50 per cent. The result is therefore the same as if the shareholder had transferred 50 per cent of its shares to the third party. It follows, it is suggested, that whether 100 new shares are issued or 50 of the existing shares are transferred, a disposition of 50 per cent of the shareholder's rights occurs. Were it otherwise, the door would be opened to the evasion of the provisions of s 341(2) and the courts may be expected to seek to avoid such a result.

Does it make a difference if the issue of shares is voted by other shareholders and the shareholder company either abstains or votes against the issue? The answer is, it is suggested, in the negative. The view has already been taken above[367] that s 341(2) does not require an act on the part of the company and if this view is correct the result would be that even an issue of shares voted by other shareholders would be a disposition by the shareholder company.[368] However, the ramifications of such an approach - eg in the case of a rights issue by a public company - are manifest, and may well lead to the courts' electing rather to interpret s 341(2) narrowly so as to avoid including the issue of shares within the meaning of 'disposition'.

In CIR v Estate Kohler & Others[369] and Estate Furman & Others v CIR[370] the question in issue was whether an issue of

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(367) See 356-61 above.

(368) The parallels between this situation and expropriation - see the previous section - are unmistakeable. Cf Pennington Company Law 82.

(369) 1953 (2) SA 584(A).

(370) 1962 (3) SA 517(A).

shares constituted a disposition within the meaning of s 3(6) of the Death Duties Act[371] which referred to "any disposition whereby any person becomes entitled to receive or acquire any property".

On the wording of the section the only relevant question was whether the allottees had received a disposition, not whether the existing shareholders had made a disposition. Nevertheless, the judgments are instructive generally on the question of whether an issue of shares is a disposition and it is therefore appropriate to quote from them at some length.

In the Estate Kohler case Schreiner JA, Fagan JA (as he then was) concurring, held that the allotment was a disposition within the meaning of s 3(6). Apart from pointing out that it did not matter on the wording of the section from whom the disposition was received or at what cost, if any, to the other party, Schreiner JA said:[372]

> 'The question is whether whatever the purpose or purposes of sub-sec. (6), "any disposition" in this context covers transactions like an allotment of shares. "Disposition" is a very wide word. In sec. 2 of the English Succession Duty Act of 1853, which defines "succession", the expression "every past or future disposition of property" is used in conjunction with "every devolution by law of any beneficial interest in property. Of these expressions LORD MACNAUGHTON said, in Duke of Northumberland v. Attorney General, 1905 A.C. 406 at pp 410 and 411:
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> > "It is clear that the terms 'disposition' and 'devolution' must have been intended to comprehend and exhaust every conceivable mode by which property can pass, whether by act of parties or by act of the law"; and again, "in many

(371) 29 of 1922.

(372) At 600C-F.

> cases, the purpose of the Act would be defeated unless you give to the term 'disposition' the largest possible signification".

These remarks, of course, do not prove that "disposition" in our sec. 3(6) is equally wide, but they support the view that "disposition" certainly in this sort of legislation carries a wide meaning. I can see no reason for not treating it in sub-sec.(6) as covering all acts in the law which affect property. In my opinion it includes such transactions as an allotment of shares by a company, although the company's estate is not diminished thereby.'

Centlivres CJ, on the other hand, in his dissenting judgment said :(373)

> '...there can obviously be no "disposition" within the meaning of that word as used in that sub-section, unless there is a disponer and a disponee, the first of whom disposes of his property to the second. In this case there was no disposition of any of its property by the company.'

In Estate Furman & Others v CIR the same question was in issue and the court found it unnecessary to express agreement or disagreement with the majority judgment in the Kohler case because the court was not satisfied that the judgment was without foundation and therefore the stare decisis rule applied. In the course of delivering the court's judgment, however, Steyn CJ said:(374)

> 'Although the expression "all acts in the law" is not perhaps a happy one, and the remarks of LORD MACNAUGHTON as to the meaning of "disposition" in a different context can, in my view, have little persuasive force as to its meaning in this sub-section, it is apparent that SCHREINER, J.A., was under no illusion of identity of context and recognised that the

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(373) At 596A.

(374) At 526 H and 527 B-C.

> assistance to be derived from these remarks was of a limited nature....
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> 'There are well-known cases in which a person disposes of property without himself parting with anything. A sheriff who sells the property of a debtor and a husband who alienates the separate property of his wife under the marital power, do not thereby diminish their own estates, but they nevertheless dispose of property in the ordinary acceptance of that term. The same applies, I think, in the case of a company allotting shares.'

It may be noted that Steyn CJ takes the view that an issue of shares constitutes a disposition by the issuing company, and this appears to have been the view of the majority in the Estate Kohler case as well.(375) The question of whether or not there was also a disposition by the existing shareholders was not considered, and it follows, it is thought, that little assistance is to be had from Steyn CJ's and Schreiner JA's remarks.

Centlivres CJ, on the other hand, held that for a disposition to occur there must be both a disponor and a disponee and accordingly that in the case of an issue of shares there is no disposition because there is no disponor. True, he too focused attention on the question of whether the company issuing its shares had disposed of its property, but implicit in his judgment is the assumption that there was no disposition by the existing shareholders either. His judgment is therefore authority against the view expressed above that an issue of shares may constitute a *disposition by the existing shareholders.*

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(375) Cf Fostoria-Fannon (Australia) (Pty) Ltd, unreported, 1979 (NSW) referred to in Paterson, Ednie & Ford Company Law Bulletin of 10 September 1979 at 102, in which it was held that the issue of shares by a company is not a disposition by the company within the Australian counterpart of s 341(2). See also Ultzman v Carribean and Southeastern Development Corporation et al 129 SE 2d 62 (CA Ga, 1962) in which the issue of stock by a corporation was held to be a disposition by the corporation within the meaning of a statute prohibiting the sale or other disposition of an unregistered security.

The case of Freewheels (India) Ltd v Mitra & Anor[376] also calls for consideration. A company in liquidation owned 52% of the shares in another company. The directors of the subsidiary resolved to raise further capital needed by the subsidiary by the issue of further shares. The company in liquidation was offered a pro rata share of the new shares but could not take them up. It then sought an injunction prohibiting the new issue. The court a quo refused the injunction but the court on appeal reversed the decision. In so doing the appeal court did not base its decision directly on the new issue being a disposition of the holding company's property within the meaning of the Indian equivalent of s 341(2), but rather on the reasoning that, having regard to the Indian equivalent of s 341(2) and other sections, the object of winding-up is the preservation of the company's property for pari passu distribution among its creditors and that it can be inferred from this that the court had the power to intervene under the Indian counterpart of s 347(1) of our Act empowering the court hearing a winding-up application to make such interim order as it deems just. The decision accordingly affords only limited support for the proposition that a share issue constitutes a disposition by the existing shareholders of their property.

(ff) Dealings by nominee

If one person holds property for another it is necessary in seeking to determine the effect of s 341(2) on any dealing with the property to distinguish between cases where ownership of the property vests in the beneficial owner from cases where ownership vests in the nominee.[377]

(376) AIR 1969 Delhi 258 at 260-261(3).

(377) The question of in whom ownership vests is complex and far from clear in our law - A M Honoré The South African Law of Trusts 2nd ed (Cape Town 1976) 396 ff.

If ownership of the property vests in the beneficial owner, any dealing with the property, whether by the beneficial owner or the nominee, either is or is not a disposition by the beneficial owner in accordance with the principles discussed in the preceding sections.

If on the other hand ownership of the property vests in the nominee, the position is more difficult. In this case, the beneficial owner has only a personal right against the nominee. If the beneficial owner cedes this right to a third party, clearly there is a disposition of the right by the beneficial owner to the third party. If, however, the nominee disposes of the property, or of rights in the property, to a third party, whether with or without the beneficial owner's authority, can there be said to be a disposition of property by the beneficial owner to the third party when the beneficial owner's personal right against the nominee is not disposed of, even though its enforceability may be adversely affected by the disposal of the property?

This question arose in Re Norman King and Co (Pty) Ltd(378) in which a property beneficially owned by a company was registered in the name of a director and the director passed a mortgage bond over the property to secure a debt owed by the company. The court held that although the mortgage affected the company's beneficial interest it was not a disposition of that interest.

The decision is, it is considered, correct. The company had a personal claim against the director for transfer of the property and the effect of the company's acquiescence in the mortgaging of the property was that its right against the director was reduced from the right to transfer of the property free of encumbrances to the right to transfer of the property subject to the mortgage. This, it

(378) (1960) 60 SR (NSW) 98 at 103.

is thought, constituted a disposition by the company to the director of a portion of the right to transfer, but this was not the issue before the court: the issue before the court was whether or not the mortgage bond itself was avoided by the Australian counterpart of s 341(2) and the court concluded that it was not.(379) One must, it is thought, agree. The real right of ownership of the property vested in the director and the effect of the mortgage was to transfer portion of this right to the mortgagee. The disposition to the mortgagee was therefore by the director not by the company. Had the company not acquiesced in the mortgaging of the property there would have been no disposition at all by the company because the company would still have had the same right, despite the mortgage, to receive transfer of the property free of encumbrances.

If the beneficial owner enjoys only a personal right to the property and the nominee delivers the property to the beneficial owner thus transferring the real right of ownership of the property to the beneficial owner, this will constitute a disposition by the nominee to the beneficial owner.(380)

(gg) Incurrence of a liability otherwise than by contract

Liabilities can arise otherwise than by contract eg by the commission, either intentionally or negligently, of a delict or on the grounds of unjust enrichment. It is considered, however, that the incurrence of such a liability cannot be construed as a disposition within the meaning of s 341(2) whether the Insolvency Act definition applies or not.

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(379) See, too, Grey & Anor v IRC [1960] AC 1 (HLE) in which it was held that a disposition occurred, in a different context, when the beneficial holder of shares instructed the nominee holder to hold them on behalf of a third party thenceforth. See also Sneddon & Others v Lord Advocate [1954] AC 257 (HLSc) especially at 265.

(380) Estate Wicks v Wicks 1929 CPD 491.

(hh) Exercise of a power of appointment

The exercise of a power of appointment, eg one conferred by will or donation, may, depending on the circumstances, constitute a disposition.(381)

(ii) Arbitration

Sandé(382) considers an agreement to arbitrate to be an alienation because it resembles a settlement. It is suggested, however, that in modern conditions this would not apply, especially if the arbitration takes place in terms of the Arbitration Act,(383)

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(381) Stanyforth & Anor v CIR [1930] AC 339 (HLE); Fuller & Anor v IRC [1950] 2 All ER 976 (Ch).

(382) Restraints 1.1.3.29; 3.3.13.

(383) 42 of 1965.

CHAPTER 11 - VALIDATION

Synopsis

Application for validation may be made either in advance or ex post facto. The criteria for validation in advance and ex post facto applications are, however, not identical. The court cannot validate a disposition which takes place after the grant of the winding-up order. The court has the power to validate dispositions generally, such as all dispositions in the ordinary conduct of the company's business. The court may validate part of a disposition, provided that in the case of a contract that part of the contract is divisible from the rest of the contract. But if 2 persons are liable to restore a void disposition the court cannot relieve one of liability without also relieving the other.

The court's discretion to validate is very wide and is controlled only by the general principles which apply to every kind of judicial discretion. Because of the wide scope of the factors which may be relevant to the exercise of the discretion no general principle has emerged in the cases on s 341(2) and its counterparts elsewhere for the exercise of the discretion, and it is not possible to formulate any such general principle. It is, however, possible to identify a number of general factors to which the courts may be expected to have regard in any proceedings for validation.

The object of s 341(2) is twofold: to avoid the dissipation of the company's assets and to ensure that concurrent creditors, both pre- and post-presentation, benefit pari passu. It is not necessary that there be an intention to give or get a preference. In an English case the Court of Appeal held that if a bank permits a customer to continue to operate its account after presentation the bank must institute safeguards to ensure that preferential payments are not made to some creditors at the expense of the others; however, with respect, the imposition of such an onus on the bank is not justified.

The policy of pari passu distribution has not been consistently applied by the courts. In the case of the preferential discharge of pre-presentation debts validation has generally been refused but in a number of cases has been granted eg because the

creditor was unaware of the presentation or because the discharge of the debt took place in good faith and the ordinary course of business. Most of these cases are indistinguishable from other cases in which the contrary was held. These latter cases are to be preferred. The policy of pari passu distribution has not been applied to the discharge of post-presentation debts and the discharge of post-presentation debts has generally been validated. However, there would appear to be no reason why some post-presentation creditors should be preferred over others and the better view is that the policy of pari passu distribution also applies to post-presentation creditors.

If validation is in the interests of all the interested parties validation may obviously be expected to be granted. Where validation is in the interests of some of the parties but not others the court will weigh up the conflicting interests of the parties. The fact that a transaction as a whole is in the interests of the parties does not necessarily mean that validation of the discharge by the company of its obligations under the contract will be in the interests of the parties.

In an advance application the court is essentially concerned with weighing up the interests of the shareholders and the creditors, although the interests of other persons such as the company's employees and the community at large may carry some weight. The greater the prospects of success of the winding-up application the more weight that will be attached to the creditors' interests and vice versa. Where there is no clear indication that the winding-up application is likely to succeed the court should rather err in favour of the shareholders. If the court validates the continued conduct of the company's business it is likely to stipulate conditions for the protection of creditors eg that only transactions in the ordinary course of business are to be entered into, that preferential payments are not to be made to some creditors at the expense of others and that the business is only to be continued as long as the assumptions on which the court's order is based - eg that the company is in a position to trade at a profit - prove to be correct. The court may moreover require that the observance of the conditions be monitored by an independent person.

In ex post facto applications the court is essentially concerned with weighing up the interests of the creditors and the disponee. If the disposition is in the interests of the creditors it will be validated. If it is not in the interests of creditors it will nevertheless be validated if considerations of justice and fairness towards the disponee require validation. The fact that a disposition would have been validated had

application been made in advance does not necessarily mean that it will be validated if application is made ex post facto.

The most commonly referred to criterion for validation is good faith but in no case has any attempt been made to define the precise nature of the required good faith or by whom and to whom it is owed. In an advance application the criterion for validation is whether the proposed disposition is in the interests of the shareholders and creditors and the good faith or otherwise of the company and the disponee are irrelevant to this question. In an ex post facto application 2 questions arise: Would validation be in the interests of the creditors, and, if not, do considerations of justice and fairness towards the disponee require validation? Good faith on the part of the company is not relevant to either of these questions, but good faith on the part of the disponee is relevant to the second question. Three relevant states of mind on the part of the disponee can be distinguished.

Firstly, if the disponee knew or ought to have known that the disposition was not in the interests of creditors validation would be inappropriate, except that if the shareholders' interests would have taken precedence had an advance application been made and the disponee knew this and relied on it, validation should not be refused because he knew that the disposition was not in the interests of creditors. It has already been mentioned that in an English case the Court of Appeal held that if a bank permits a customer to continue to operate its account after the bank has become aware that a winding-up application has been presented against the customer the bank must institute safeguards to ensure that preferential payments are not made to some creditors at the expense of others. The court also held that the bank must institute safeguards to ensure that the company only continues to operate its account as long as the continued conduct of its business is in the interests of creditors; however, with respect, the imposition of such an onus on the bank is not justified.

Secondly, in a number of cases a disposition has been validated on the ground that the disponee was unaware of the presentation of the winding-up application. However, there would not appear to be any reason why a creditor should be entitled to retain a preference simply because he was unaware of the presentation at the time of receiving the preference, and the cases in which validation was refused despite the absence of knowledge of the presentation are to be preferred. On the other hand, the fact that the disponee was aware of the presentation is not a bar to validation. A bank will apparently be regarded as having notice of the presentation when its head office receives notice even if

there is a delay in the notice coming to the attention of the branch at which the company banks.

Thirdly, if the disponee's motive in entering into a transaction was to assist the company rather than the pursuit of personal gain this will weigh in his favour. This is so even if the transaction does not in fact benefit the company or if he was unreasonable in his belief that the transaction was in the interests of the company, although in these latter situations the weight that will be attached to his motives is likely to be less.

Another commonly referred to criterion for validation is that the disposition was in the ordinary course of the company's business. The classic formulation of the test is that of Lord Cairns in the Wiltshire case:

> '... where a company actually trading, which it is in the interest of every one to preserve, and ultimately to sell, as a going concern, is made the object of a winding-up petition, which may fail or may succeed, if it were to be supposed that transactions in the ordinary course of its current trade, bonâ fide entered into and completed, would be avoided, and would not, in the discretion given to the Court, be maintained, the result would be that the presentation of a petition, groundless or well-founded, would, ipso facto, paralyse the trade of the company, and great injury, without any counterbalance of advantage, would be done to those interested in the assets of the company.'

Although Lord Cairns refers to transactions entered into and completed after presentation, his statement has been understood - wrongly it is believed - in some subsequent cases to also refer to the discharge of pre-presentation debts. However, even in the case of transactions entered into and completed after presentation Lord Cairns' statement does not, with respect, stand up to close scrutiny.

In an advance application validation will be granted if the disposition is in the interests of the shareholders and creditors whether or not it is in the ordinary course of the company's business. Where, however, the interests of the shareholders and the creditors are in conflict and there is no clear indication that the winding-up application is likely to succeed, the ordinary course of business test does have a role to play in that the shareholders' interests should be given precedence and all dispositions necessary for the continued conduct by the company of its business in the ordinary course

should be validated in order to avoid the paralysis of the business. The test is, however, that the disposition is necessary for the continuation of the company's business, not simply that it takes place in the course of the continuation of the business.

The Wiltshire case was an ex post facto application but it is especially in the case of ex post facto applications that difficulties arise in regard to Lord Cairns' formulation of the test. Firstly, by the time the application is made the avoidance of the paralysis of the company's business will have ceased to be relevant to the company concerned because paralysis will either have been avoided or not. Secondly, the test as formulated by Lord Cairns is in any event unlikely to achieve the object of the avoidance of the paralysis of the company's business because it is predicated upon 2 conditions, namely that the disposition is not merely in the ordinary course of business but in the ordinary course of the company's business, and that it is in the interests of all concerned that the business of the company should be continued. Few persons proposing to have dealings with the company may be expected to be willing to accept the onus of investigating whether these conditions are met. Thirdly, the test does not take account of cases where the disponee is unaware of the presentation and is therefore unable to carry out the required investigation.

The fallacy, with respect, in Lord Cairns' approach is that it seeks to formulate the test with reference solely to the interests of those interested in the assets of the company and without reference to the disponee's interests. The view has already been taken that in an ex post facto application 2 questions arise: is validation in the interests of creditors, and if not do considerations of justice and fairness towards the disponee nevertheless require validation? This approach encompasses the object of avoidance of the paralysis of the company's business in that if a person proposing to have dealings with the company knows that justice and fairness towards him will be the criterion if it becomes necessary to seek validation of the dealings, he will have no reason on this ground to refuse to have dealings with the company. This approach, however, is wider than the object of the avoidance of the paralysis of the company's business because it applies whether or not the disponee was aware of the presentation, whereas the object of avoidance of the paralysis of the company's business essentially only arises if the disponee was aware of the presentation because if he was unaware of the presentation there is no reason why he would have refused to have dealings with the company.

Justice and fairness towards the disponee require validation essentially of 3 categories of transaction:

- the conclusion by the disponee in good faith of any normal, arm's length contract with the company;

- the discharge by the company of any obligation to the extent the discharge was relied on in good faith by the disponee in discharging an obligation owed by him to the company or in his undertaking and discharging such an obligation;

- the discharge by the company of any obligation in the course of a series of transactions to the extent non-validation would result in the disponee's claim exceeding the highest level it rose to after presentation even if the disponee did not specifically rely on the discharge of earlier debts in granting new credit, provided always that the disponee acted in good faith.

Compassion for the disponee is not a relevant factor. The Insolvency Act impeachment provisions may serve as a guide to how the courts should exercise their discretion but a court is not bound to validate a transaction because it would be valid under the Insolvency Act provisions or vice versa. It is not necessary that the company should positively benefit by the disposition. It is also no part of the policy of s 341(2) that the company should be enriched at the expense of the disponee. The court is likely to be less critical of decisions which prove to be incorrect if they had to be taken as a matter of urgency.

If the company wishes to make a preferential payment to avoid the cancellation of a valuable contract the court may be expected to validate the payment in an advance application, but if application is made ex post facto the threat of cancellation has passed and the court may be expected to refuse to validate the payment, except in the case of a continuing contract, such as a lease, in which the other party continued to perform his obligations in reliance on the payment.

If a creditor is only willing to enter into further transactions essential for the continued conduct of the company's business on condition that a preferential payment is made to him on account of the creditor's existing claim, the court may be expected to validate the payment in an advance application provided that the transaction as a whole is beneficial to creditors. In an ex post facto application, however, validation may be expected to be refused even if creditors benefited as a result of the transaction.

The fact that a disposition is made under threat of legal action is neither favourable nor unfavourable to validation.

The court may have regard to the fact that none of the interested parties objected to the transaction. The fact that a payment is made in respect of some past consideration is not a sufficient reason for validation. It has been held that a provision such as s 341(2) should be given a practical interpretation so that it will operate in a commercial way. The court is not limited to a consideration of the immediate circumstances surrounding the disposition but may in addition have regard to the circumstances giving rise to the disposition, but this should not be taken too far.

The fact that the company may have employed dilatory tactics preventing the disponee from obtaining and executing judgment will not avail the disponee. Nor will the fact that the disponee may have accepted payment of part of his claim in settlement. The fact that the disponee was the applicant for winding-up has been held to be a factor adverse to validation but it is doubted whether the fact that the disponee was the applicant makes a difference.

The cases on the continued operation of a bank account present a confusing and inconsistent picture.

The most important of these cases is the recent Gray's Inn case in which the English Court of Appeal validated all deposits to the company's account, which was in overdraft, before the bank became aware of the presentation, but refused validation of subsequent deposits equal to the trading loss incurred by the company after presentation, on the ground that the bank had failed to institute safeguards to ensure that the company only continued to operate its account as long as it traded at a profit. The court held further that payments out of the account to third parties were dispositions which the bank was liable to restore to the liquidator unless validated, and that the bank was vulnerable to a refusal to validate the payments because it had not instituted safeguards to ensure that preferential payments were not made to some pre-presentation creditors at the expense of the others, although recovery should in the first instance be sought from the preferred creditors. The court also held that the bank bore the onus of instituting safeguards to ensure that only payments in the ordinary course of the company's business were made out of the account. However, the case is extensively criticised.

In the International Life case the company gave security to its bankers for their pre-presentation claim in order to gain time

to complete negotiations for the sale of the company's business and the court validated the security on the ground that the directors had acted bona fide in the desire to do the best for all concerned, even though in the event the negotiations were unsuccessful. This reasoning is criticised on the ground that the appropriate action for the company to have taken would have been to have sought a stay of any proceedings the bankers might have instituted. The decision can, however, be supported on a different ground: the directors also gave their personal suretyships to the bankers with the result that they would have been the ones to suffer had validation been refused, and this would have been harsh on them as they were motivated solely by the desire to do the best for the company even at the risk of personal loss.

In Millar's case the company after presentation first made a deposit to its account and then withdrew portion of the deposit again. The liquidator sued for the full amount of the deposit and the bank tendered the net amount after deduction of the withdrawals. The court upheld the liquidator's claim. However, the decision largely turned on a statutory provision peculiar to Scottish windings-up.

In the JW Construction case the company's account was in overdraft at presentation. It thereafter first withdrew further monies from the account and then largely repaid the entire overdraft. The court validated the repayment on the grounds that it was made in good faith and the ordinary course of business. This decision too is criticised, in this case on the ground that there was no adequate reason for the bank to be preferred over the other creditors.

In the Anhadra Bank case the bank, which was unaware of the presentation, lent and advanced monies to the company against security furnished by the company. The court refused validation of the security on the ground that the company was aware that there was no possibility of its continuing its business in the ordinary course. Yet again, however, this decision is criticised, this time on the ground that justice and fairness to the bank required that the security be validated.

The Clifton Place Garage case, also a decision of the English Court of Appeal, does not relate directly to the continued operation of a bank account but is nevertheless relevant because the company's parent company in effect acted as its banker. On presentation of the winding-up petition, the company's bank froze its account and the debenture-holders of its parent company appointed a receiver to the parent company. The receiver decided to continue the subsidiary company's business with a

view to selling the business as a going concern and for this purpose made payments from the parent company's bank account to the subsidiary company's creditors and in turn deposited the subsidiary company's daily takings to the account. The court validated the deposits on the grounds that the receiver acted in good faith in what he reasonably believed to be the best interests of all concerned; that he would not have made the payments had the deposits not been available as a counterbalance; and that the creditors would have been unjustly enriched if the deposits had not been validated. The decision is, with respect, correct: had the daily takings not been deposited to the parent company's account the receiver would no doubt have refused to make payments on behalf of the subsidiary company. The receiver therefore relied on the deposits in making the payments and this fact coupled with his good faith entitled him to validation.

A company which applies in advance for validation of the continued operation of its bank account will need to show either that such continued operation is in the interests both of the creditors and of the shareholders or that the shareholders' interests should take precedence. If the court grants a validation order it may be expected to stipulate for safeguards to ensure that:

- Payments are only made out of the account in the ordinary course of the company's business;

- Preferential payments are not made to some creditors and not others, except where it is in the interests of creditors to do so;

- The account only continues to be operated if, and for as long as, the assumptions on which the court's order was based prove to be correct.

The court may well require that the observance of the conditions it lays down be monitored by an independent person.

The furnishing of security for new overdraft facilities may similarly be expected to be validated if the continued operation of the account otherwise qualifies for validation, but if the bank is only prepared to grant increased facilities if both the existing and new facilities are secured validation of the security insofar as it relates to the existing facility may only be expected if it can be shown that the benefit to creditors will exceed the prejudice arising from the preferential securing of the existing facility.

Different considerations apply in an ex post facto application.

If the account is in credit and a deposit is made to the account both the payment to the bank and the contract of loan to which it gives rise should be validated on the ground of absence of prejudice to the creditors. Payments to the company are not dispositions and therefore do not require validation. Payments to third parties in accordance with the company's instructions must be analysed into 2 payments: a payment by the bank to the company, which is not a disposition by the company, and a payment by the company to the third party, which is such a disposition but which is recoverable from the third party, not the bank.

If the account is in overdraft, deposits to the account constitute repayments on account of the company's indebtedness to the bank and the policy of pari passu distribution requires that they should not be validated, except that if the bank relied on the deposits in permitting withdrawals justice and fairness to the bank require that the deposits be validated to the extent they were so relied on. Even if the bank did not specifically rely on the deposits, validation should not be refused to the extent such refusal would result in the bank's claim being higher than the highest level it in fact reached after presentation. Where neither of these exceptions applies, it will not avail the bank that it was unaware of the presentation of the winding-up application, or that there was no intention to give or get a preference, or that the deposits were made in good faith and the ordinary course of business, or that the bank gave an extension of time for payment of the balance of its claim in consideration of the deposit.

Although payments out of the account are not dispositions, the contracts of loan to which the payment instruction concerned give rise where the account is in overdraft are dispositions. In the case of payment instructions given outside the scope of an overdraft facility the resulting contracts of loan should be validated unless they were not normal and arm's length or the bank knew or ought to have known that they were not in the interests of creditors, except that if the shareholders' interests would have taken precedence at the time and the bank knew this and relied on it validation should not be refused on the ground that the bank knew that the loan was not in the interests of creditors. In the case of payment instructions given within the scope of an overdraft facility the bank is obliged to honour the payment instruction and should therefore normally be entitled to validation. The question of what notice is required to terminate this obligation and of whether the bank

may be refused validation if it does not do so is considered in chapter 15.

In determining whether or not a loan was in the interests of the creditors it is not only the terms and conditions of the loan itself that are relevant but also the intended use to which the monies borrowed are to be put. On the other hand, there is no onus on the bank to institute safeguards to ensure that withdrawals are only made in the ordinary course of the company's business or that preferential payments are not made to certain creditors to the prejudice of the other creditors or that withdrawals are only made as long as it is in the interests of creditors that the company's business should be continued.

If the company furnishes security for its existing overdraft the security constitutes a preference to the bank and should not be validated. Even if the security was established before presentation a new disposition occurs as each debt is incurred and becomes secured by the security. If the contract of loan giving rise to the debt is validated the disposition constituted by the debt's having become secured by the security should likewise be validated by reason of the bank's reliance on the security in giving the credit concerned. The position is similar where the security was established after presentation.

If not only existing property but also future property is furnished as security a new disposition occurs as each new item of property becomes subject to the security, even if this occurs automatically. Each such new disposition should be validated save to the extent it improves the bank's position. Similarly, if a new security is substituted for an old security the furnishing of the new security should be validated save insofar as it improves the bank's position.

The bank's charges for a deposit or withdrawal should be validated if the transaction to which the charge relates is not avoided by s 341(2) whether the transaction is not avoided because it is not a disposition or because it is validated. If the account was in credit the set-off of the charges against the credit should be validated on the ground that the bank did not extend credit to the customer for the charges.

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In terms of s 341(2) a disposition is void 'unless the Court otherwise orders', and consideration is given in what follows to the circumstances in which the court will validate a disposition in the exercise of this power.

(1) Advance and ex post facto[1] validation

(a) Can a validation order be granted either in advance or ex post facto?

In In re International Life Assurance Society Gibbs and West's Case[2] the court rejected - correctly it is considered - the argument that the court can only validate a disposition if validation is sought at the time of the disposition, and in fact in the majority of cases in which validation orders have been granted under the counterparts elsewhere of s 341(2) the order has been granted after the company has been placed in winding-up.[3] It seems, however, that there may be cases in which application ought to be made in advance and in which validation will be refused if application is made ex post facto:

> 'I am told that in In re Howard Sunderland Ltd.,[4] Roxburgh J. on an application which was made after the date of the winding-up order, refused to validate a transaction under section 227, or its predecessor, on the ground that the applicant, having regard to the nature of the transaction and to the circumstances which existed when he entered into the transaction with the company, ought to have applied to the court under the section at the date of the transaction, that is to say, before the winding-up order had been made'

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(1) The expression 'ex post facto' is used in this chapter to refer to an application which is made not only after the disposition in question has taken place but also after the grant of the winding-up order.

(2) (1870) 10 Eq 312 at 317 and 324. See too Tulsidas v Industrial Bank of Western India AIR 1931 Bombay 2 at 12; Khanna v Ghosh 1976 MhLJ 150 (Bombay) at 154.

(3) See eg In re Wiltshire Iron Company Ex p Pearson (1868) 3 Ch App 443; In re Clifton Place Garage Ltd [1970] Ch 477 (CA); Re Gray's Inn Construction Co Ltd [1980] 1 All ER 814(CA).

(4) 1948, unreported.

(per Buckley J in In re A I Levy (Holdings) Ltd[5]).

The question of whether a court can grant a validation order before a winding-up order has been granted is more difficult. In Carden v The Albert Palace Association[6] Chitty J said:

> 'The difficulty in making an order before a winding-up is that it is impossible to know whether all parties interested are before the Court.'

Nevertheless the court granted the order on being satisfied that the disposition was in the interests of all the interested parties.

In In re Miles Aircraft Ltd,[7] on the other hand, Vaisey J held:

> 'If a winding up order is made, those transactions entered into in the interim period ... should be liable to review by the liquidator. If that be the true object of the section I have great difficulty in seeing how I have jurisdiction to adjudicate on what must be an incomplete knowledge of the facts. It is not right that I should anticipate the performance of his duty by the liquidator.'

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(5) [1964] Ch 19 at 26-7. What the circumstances referred to by Roxburgh J were does not appear from Buckley J's judgment. A disponee may be well-advised to insist on validation in advance to avoid the risk of a subsequent refusal of validation. Moreover, as will be shown below, in certain circumstances an application may succeed if made in advance but not if made ex post facto eg where the only supplier of goods essential for the company's business is only prepared to supply further goods if a preferential payment is made in respect of his existing claim. It is difficult to conceive what further, if anything, Roxburgh J may have had in mind, cf too In re Répertoire Opera Co (1895) 2 Mans 314 at 316.

(6) (1887) 56 LJ Ch 166 at 167.

(7) [1948] Ch 188 at 190.

Vaisey J's reasoning was, however, in turn rejected in In re A I Levy (Holdings) Ltd:[8]

> '... I find it difficult to accept his statement that the object of the section is to ensure that any transaction entered into after the commencement of the winding up shall be "subject to review by the liquidator". It appears to me that the object of the section is to protect the interests of the creditors[9] from the possibly unfortunate results which would ensue from the presentation of a petition, and to protect their interests as much during the period while the petition was pending as after an order has been made on it ....
>
> 'It does not appear to me, with the utmost respect to Vaisey J., that the language of the section necessarily requires an order to be made in respect of a company which is in fact being wound up by the court at the date when the order under section 227 is made, that is to say, after the date of the winding-up order. If that were the true effect of the section, the present case would demonstrate that the section is ill designed to meet a kind of risk to the creditors of a company against which one would have expected it to be intended to protect them.'

The facts of the case were that after a winding-up petition had been presented against the company it received an offer to purchase a lease held by it. The landlord was entitled to cancel the lease if a winding-up order was granted. The court validated the sale of the lease.

The same approach, that the court can validate dispositions in advance, is to be found in a number of other English cases. In Re Gray's Inn Construction Co Ltd[10] Buckley L J said, without

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(8) [1964] Ch 19 at 27-8.

(9) The shareholders' interests are also important - see 514-24 below.

(10) [1980] 1 All ER 814 (CA) at 820 f-g. See too Re Douglas (Griggs) Engineering Ltd [1962] 1 All ER 498 (Ch) at 501A-B; Re Operator Control Cabs Ltd [1970] 3 All ER 657 (Ch) at 658g-h; Re Burton & Deakin Ltd [1977] 1 All ER 631 (Ch) at 634e. The Jenkins Committee Report # 503(k) recommended that the Act be amended to expressly empower the court to grant validation orders in advance but the recommendation has not been implemented.

referring to the earlier cases:

> 'Where a third party proposes to enter into a transaction with a company which is liable to be invalidated under s 227, the third party can decline to do so until the company has obtained a validating order, or it might itself seek a validating order, or it can enter into the transaction in anticipation of the court making a retroactive validating order at a later date. In the present case the bank adopted the last course. A third party who does that takes the risk of the court refusing to make the order.
>
> 'It may not always be feasible, or desirable, that a validating order should be sought before the transaction in question is carried out. The parties may be unaware at the time when the transaction is entered into that a petition has been presented; or the need for speedy action may be such as to preclude an anticipatory application; or the beneficial character of the transaction may be so obvious that there is no real prospect of a liquidator seeking to set it aside, so that an application to the court would waste time, money and effort. But in any case in which the transaction is carried out without an anticipatory validating order the disponee is at risk of the court declining to validate the transaction.'

In India, on the other hand, the opposite conclusion has been reached:

> 'It may be pointed out that the situation visualised by this section does not arise before winding up order is passed by the Court .... In our opinion, the scheme of the Act is, that so long as a Company is not ordered to be wound up by the Court, it should not, in the ordinary course pass any order with regard to the property of the Company. If it comes to the conclusion that the appointment of a provisional liquidator is necessary, then it may do so but this step would mean that the Court would be dealing with the entire property with full responsibility. If the appointment of a provisional liquidator is not considered to be necessary, then it should not meddle with the management or disposal of the property of the Company. If the winding up application is dismissed, the Court's interim interference would be unjustified. If the winding up order is passed, then also it would find itself in a difficult situation if its earlier order is found to be erroneous in any way. The result of the passing of winding up order according to Section 536(2) is that all dispositions made subsequent to the presentation of the winding up application become automatically void, unless the Court orders otherwise. This section, therefore does not contemplate any previous order of the Court about disposition of the property of the Company'

(per Dave J delivering the judgment on appeal in Ramesh Chandra v Chopasni Ice Aerated Water and Oil Mills Ltd[11]). This reasoning, however, is of only limited applicability to the situation in this country because a fundamental part of the court's reasoning was that the appropriate procedure would have been not to seek validation in advance but to seek the appointment of a provisional liquidator, a procedure which is not available under our Act.[12]

In Australia the difficulty does not arise because the Australian counterpart of s 341(2) expressly empowers the court to grant an advance validation order.[13]

The better view is, it is thought, that the court can validate a disposition in advance.[14] True, s 341(2) provides that 'Every disposition ... by any company being wound up ... shall be void unless the Court otherwise orders' and the tenses employed give the impression that the legislature contemplated the validation order's being preceded by the winding-up order. It is doubted, however, whether much weight can be attached to this consideration. As already pointed out,[13a] a similar problem arises in regard to s 348 which provides that 'A winding-up ... shall be deemed to commence at the time of the presentation to the Court of the

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(11) AIR 1963 Rajasthan 187 at 189(14). See also R C Mehta & Co & Others v Himabhai Manufacturing Co Ltd & Anor (1970) 40 Comp Cas 1230 (Guj). Cf Mandya National Paper Mills Ltd v Rai Bahadur Shreoram Durgaprasad Private Ltd (1967) 37 Comp Cas 20 (Mys).

(12) A similar procedure is available under the English and Australian Acts - see 249-50 and 253 above.

(13) See s 368(2) of the Companies Act 1981 (Cth).

(13a) See 255-6 above.

(14) Henochsberg Companies 595.

winding-up application', and in Vermeulen & Anor v CC Bauermeister (Edms) Bpk & Others[15] the court held that this does not mean that a winding-up commences as soon as a winding-up application is presented, but that if a winding-up order is granted the winding-up is deemed to have commenced on presentation of the application.

It is also thought that the reason given by Vaisey J, namely that the disposition should first be reviewed by the liquidator, is no more than a consideration which may cause the court in any particular case to decline to exercise the discretion to validate until the liquidator has had an opportunity to review the disposition. It is not, with respect, a reason for holding that the court has no power to validate before the liquidator has had such an opportunity.[16]

The reasoning in the A I Levy case is to be preferred. If the court's power to validate could not be exercised in advance, the mere presentation of a winding-up application, whether well-founded or not, might well paralyse the company's business. Few persons may be expected to be willing to deal with a company if they are aware that a winding-up application has been presented against the company[16a] and if no advance validation order has been obtained with the result that they have to run the risk of having to apply in due course for validation.[17] The prospects of the court granting

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(15) 1982(4)SA 159(T) at 162B.

(16) This appears to have been the approach of Chitty J in the Carden case.

(16a) See further 545-54 below.

(17) It is true that in this country most persons will be unaware of the presentation because of the confidentiality accorded to proceedings before they are heard in court - see 249 above - but in practice the confidentiality is seldom complete eg the application may be served on an employee or by pinning it to the front door of the company's premises, resulting in some publicity.

a validation order are too uncertain [18] and the cost and effort required to apply for validation are too great. It follows, it is thought, that the courts may be expected to rather interpret s 341(2) as empowering them to validate dispositions not only after the grant of a winding-up order but also prior thereto.

(b) Are the criteria the same for advance and ex post facto applications?

The question of whether the criteria for validation are the same in advance and ex post facto applications has not been discussed in any of the cases. In certain cases, however, there are statements which could be interpreted as indicating that the criteria are the same and in other cases there are statements indicating the contrary.

In In re Clifton Place Garage Ltd[19] Sachs LJ said:

> 'The test to be applied to his [the disponee's] actions was not whether they were in the upshot successful in benefiting the creditors, nor even whether, months later, after analysis in the calmer atmosphere of a court, his decision appears correct in the light of after-acquired knowledge.'

Similarly, in Tulsidas v Industrial Bank of Western India[20] the Bombay Court of Appeal held that where validation is sought ex post facto the position must be looked at as if the application had been brought at the time the disposition took place. The company had granted the defendant security for its claim to gain time for the consideration of a scheme of arrangement or to sell its business. In the event the time granted did not assist the company but the cou. held this not to be relevant, although in the event the court did not validate the security.

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(18) See 231-42 above and 494ff below.

(19) [1970] Ch 477(CA) at 493B.

(20) AIR 1931 Bombay 2 at 4 and 23-4. Cf too Ram Lal v Official Liquidator, Benares Bank Ltd AIR 1942 Allahabad 141 at 144b Anhadra Bank Ltd v Narayana Rao AIR 1955 Madras 247 at 250.

On the other hand, in Re Gray's Inn Construction Co Ltd[21] Buckley LJ said:

> 'It seems to me that, if the matter came before Templeman J, he was bound to deal with it in the light of all the facts then known to him, including the fact, according to his finding, that the company had traded at a loss.[22] The bank, having taken the risk of going on without the protection of a validating order, must, it seems to me, take the consequences.'

The question of whether the criteria for validation are the same or not in advance and ex post facto applications will be examined further below[23] in dealing with the factors relevant to the question of whether or not a disposition should be validated and it suffices to note here that the view that will be taken there is that the criteria for validation in advance and ex post facto applications are in fact significantly different.

(2) Validation of post-winding-up dispositions

Can the court validate a disposition which takes place after the grant of the winding-up order?

The original forerunner of s 341(2), s 153 of the English Companies Act 1862, referred to dispositions between the commencement of the winding-up and the grant of the winding-up order. However, all subsequent English Acts[24] refer simply to

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(21) [1980] 1 All ER 814 (CA) at 822b.

(22) Validation had been sought ex post facto of the continued operation of a bank account and the trading loss referred to had been incurred after the bank had agreed to allow the company to continue to operate its account despite the presentation of a winding-up petition against the company.

(23) See 494ff below.

(24) With effect from the Companies (Consolidation) Act 1908 (s 205(2)). Cases prior to this date - such as In re Onward Building Society [1891] 2 QB 463(CA) - must be approached with caution.

dispositions after the commencement of the winding-up and both the 1926 and 1973 Acts do likewise.[25] Prima facie, therefore, s 341(2) applies not only to dispositions between presentation of the winding-up application and the grant of the winding-up order but also to dispositions after the grant of the order, and this is the approach adopted in a number of cases on the counterparts elsewhere of s 341(2):

> '... the prime purpose of introducing the above provision was to invalidate dispositions between the filing of the petition ... and the making of the order .... But clearly, in terms, the operation of the section would not come to an end with the making of the order'

(per Gillard J in Krextile Holdings (Pty) Ltd v Widdows; Re Brush Fabrics (Pty) Ltd[26]). Similarly, in Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor[27] the South West Africa Division assumed, without discussion, that s 341(2) applies to dispositions - payment in that case - after the grant of the winding-up order.

The correctness of this approach may, however, be questioned, at least insofar as s 341(2) is concerned. It seems clear that the section cannot apply to dispositions by the liquidator[28] and as

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(25) The Transvaal Companies Act 31 of 1909 (s 178(1)) on which the 1926 Act was based - see 244 above - did so too, but the Cape and Orange Free State Acts followed the English Act of 1862: s 196 of the Companies Act 25 of 1892(C); s 38 of the Wet op Liquideeren van Naamlooze Vennootschappen 2 of 1892(O).

(26) [1974] VR 689 at 696 (35-40). See, too, Re Dittmer Gold Mines Ltd (No 3) [1954] SR (Qld) 275 at 283. Cf Khanna v Ghosh 1976 MhLJ 150 (Bombay) at 154; A Stiebel Company Law and Precedents 3rd ed (London 1929) at 828-9.

(27) 1980(4) SA 669 (SWA).

(28) Section 386 of the Companies Act 1973; Henochsberg Companies Supplement 115; Krextile Holdings (Pty) Ltd v Widdows; Re Brush Fabrics (Pty) Ltd [1974] VR 689 at 696(45-50); McPherson Liquidation 144.

he is the only person who can represent the company after the grant of the winding-up order[29] it would not seem possible to speak of a disposition by the company[30] unless it is made by him. It follows, it is thought, that s 341(2) has no application after the grant of the winding-up order.

This was the conclusion reached in regard to voluntary windings-up in In re London and Mediterranean Bank Bolognesi's Case.[31] After the commencement of the winding-up a director purported to accept a bill on behalf of the company. The holder sought validation of the acceptance under the English counterpart of s 341(2) but the court held that the section did not apply because the directors' powers ceased on the commencement of the winding-up and therefore the bill was not the bill of the company. The same is, it is considered, true of a winding-up by the court.[31a]

(3) Validation of dispositions generally

Can the court validate dispositions generally eg all dispositions in the ordinary conduct of the company's business? This question only really arises in the case of advance applications for validation, but is of considerable practical significance because if the answer is in the negative a company may well be compelled to make a series of applications to enable it to continue its business.

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(29) See 165 n 14 above.

(30) These words, it may be noted, do not appear in the English, Australian and Indian Acts - see 356-61 above.

(31) (1870) 5 Ch App 567.

(31a) In a voluntary winding-up the Act expressly provides that the directors' powers cease on the company's being placed in winding-up and although the Act is silent in regard to the position in a winding-up by the court it has been held that the directors' powers also cease on the company's being placed in such winding-up - see 165 or 4 above.

The Australian Companies Act expressly empowers[32] the court to *grant such an order but the South African, English and Indian Acts* are silent on the point.

In Re Gray's Inn Construction Co Ltd,[33] an ex post facto application, Buckley LJ appears to have considered that the court does have this power:

> 'It may sometimes be beneficial to the company and its creditors that the company should be enabled ... to continue to carry on its business generally in its ordinary course with a view to the sale of the business as a going concern. In any such case the court has power under s 227 to validate ... the continuance of the company's business in its ordinary course ....'

It is considered that this is correct. The object of the court's power is the avoidance of unnecessary prejudice to the creditors and *shareholders of the company, and this object would be frustrated in* a material respect if the company were to be compelled to make a series of validation applications at a time when it could least afford to do so. In England, Australia and India this problem is

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(32) Section 368:

> '(2) Notwithstanding sub-section (1), the Court may, where an application for winding up has been filed but a *winding up order has not been made, by order:*
>
> (a) .....
>
> (b) permit the business of the company or a portion of the business of the company to be carried on, and such acts as are incidental to the carrying *on of the business or portion of the business to* be done, during the period before a winding up order (if any) is made,
>
> on such terms as it thinks fit.'

(33) [1980] 1 All ER 814 (CA) at 819j - 820a.

mitigated to some extent by the fact that a provisional liquidator can be appointed during the pendency of the winding-up petition[34] but this is not so in this country. The courts may therefore be expected to give an extensive, rather than a restrictive, interpretation in this respect to the words 'unless the Court otherwise orders'.

In several English cases such orders have been granted.[35] True, in all the cases the company was able to pay its debts - the English counterpart of s 341(2) is not restricted to companies which are unable to pay their debts - but this does not detract from their value as authorities that the court has the power to validate dispositions generally. If the company is unable to pay its debts the court is likely to be less ready to grant such an order but this is not a reason for concluding that the court does not have the power to grant such an order.

(4) Validation of a part of a disposition.

Can the court validate part of a disposition? For example, if a supplier is owed R200 by the company at presentation and requires payment of the R200 before supplying more goods, and if the R200 is paid but the supplier has only supplied further goods to the value of R150 by the time the winding-up order is granted, could the court validate R150 of the payment of R200?

The answer is, it is suggested, in the affirmative. Section 341(2) declares dispositions void 'unless the Court otherwise orders'. True, the section does not state 'save to the extent the Court otherwise orders'; however, it is thought that if

(34) See 249-50 and 253 above.

(35) Re Operator Control Cabs Ltd [1970] 3 All ER 657 (Ch); Re Argentum Reductions (UK) Ltd [1975] 1 All ER 608 (Ch); Re Burton & Deakin Ltd [1977] 1 All ER 631(Ch).

the court has the power to order that the whole disposition is not to be void, it also has the lesser power to order that a part only of the disposition is not to be void. The opposite interpretation would materially restrict the court's power to do justice as between the interested parties. This also appears to have been the view of the court in Re Gray's Inn Construction Co Ltd,[36] because the court validated all deposits to the company's bank account less an amount of £5 000 without enquiring whether there were deposits which totalled exactly £5 000.

If the disposition consists of the conclusion of a contract could the court validate a portion only of the contract? If the portion concerned is divisible from the rest of the contract there would clearly be no difficulty in the way of the court's validating that portion. If, however, the portion concerned is not divisible from the rest of the contract the validation of that portion would, it is considered, be ineffectual in the absence of the other party's consent because if any part of the contract is void the entire contract must be void. Similarly, the validation of the performance by the company of its obligations under an indivisible portion of a contract would not entitle the liquidator to enforce performance of the other party's obligations under that portion of the contract without a tender of performance of the company's obligations under the rest of the contract.

More complex situations are also conceivable. For example, a supplier may agree to supply goods ordered by the company provided that payment is made in advance and payment but not delivery may have taken place by the time the winding-up order is granted. In these circumstances could the court validate a portion of the

(36) [1980] 1 All ER 814(CA) at 825j. Cf too Re Steane's (Bournemouth) Ltd [1950] 1 All ER 21 (Ch) at 24F.

payment equal to, say, the expenses incurred by the supplier? Again it is thought that the answer is in the affirmative, although the further uncertainty this introduces into the scope and effect of s 341(2) is manifest.

If 2 parties are liable to restore a void disposition can the court order that one, but not the other, is to be released from liability? This question arose in the Gray's Inn[37] case. A bank had allowed a customer to continue to operate its current account after presentation of a winding-up petition against the customer. The Court of Appeal held that payments made pursuant to cheques in favour of third parties are void dispositions[38] and that both the bank and the third parties are liable to the liquidator to restore the amounts paid. The court, however, validated the payments 'as between the company and the bank',[39] apparently intending to leave the liquidator free to recover the payments from the third parties.[40]

This interpretation of the English counterpart of s 341(2) is very wide and it may be questioned whether the interpretation is correct. A disposition is void unless the court otherwise orders; it follows, it is thought, that if the court otherwise orders the disposition is not void and it would not be recoverable from any party who would otherwise be liable therefor.

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(37) Supra at 823e and 826a.

(38) At 818h-819a and 823e. This finding is criticised at 381-91 above.

(39) At 826a.

(40) See eg 823e.

(5) Scope of the court's discretion

The discretion conferred on the court by s 341(2) to validate dispositions which would otherwise be avoided by the section is very wide:

> 'In Re Steane's (Bournemouth) Ltd, [1950] 1 All ER 21 at 25, Vaisey J said that the legislature, by omitting to indicate any particular principles which should govern the exercise of the discretion vested in the court by the section, must be deemed to have left it entirely at large and controlled only by the *general principles* which apply to every kind of judicial discretion. I do not at all dissent from that statement beyond saying that the discretion must, in my opinion, be exercised in the context of the liquidation provisions of the Companies Act 1948'

(per Buckley LJ in Re Gray's Inn Construction Co Ltd[41] in relation to the English counterpart of s 341(2). The general principles which apply to every kind of judicial discretion are that it must be exercised in accordance with reason and justice, not arbitrarily:

> '..."discretion" means when it is said that something is to be done within the discretion of the authorities that that something is to be done according to the rules of reason and justice, not according to private opinion ...; according to law, and not humour. It is to be, not arbitrary, vague, and fanciful, but legal and regular. And it must be exercised within the limit, to which an honest man competent to the discharge of his office ought to *confine himself*'

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(41) [1980] 1 All ER 814(CA) at 819f-g. Vaisey J's statement has been cited repeatedly: see eg Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor 1980(4) SA 669 (SWA) at 678D; Commercial Grain Producers Association v Tobacco Sales Ltd 1983(1) SA 826(ZS) at 830G-H.

(per Lord Halsbury LC in Sharp v Wakefield & Others[42]).

(6) Factors relevant to the exercise of the court's discretion

In In re Clifton Place Garage Ltd[43] Harman LJ said in relation to the English counterpart of s 341(2):

> 'That is an extremely jejune direction to the court, and it is not surprising that the cases do not seem to give very much help.'[44]

In the United States the courts exercised a similar equitable discretion until 1938 and the result was described by Harlan J in the United States Supreme Court in Bank of Marin v England[45] as 'a crazy quilt of contradictory judicial statements.'[46]

The view has already been taken[47] that this type of uncertainty is an almost inevitable consequence of as wide a

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(42) [1891] AC 173(HLE) at 179. Although this was said in relation to a discretion vested in an official, it is, it is considered, equally applicable to a discretion vested in a court. See too Pretoria North Town Council v Al Electric Ice-Cream Factory (Pty) Ltd 1953(3) SA 1(A) at 12H.

(43) [1970] Ch 477(CA) at 490C, quoted with approval in Commercial Grain Producers Association v Tobacco Sales Ltd 1983 (1) SA 826 (ZS) at 830 G-H.

(44) Cf, too, McPherson Liquidation 145:

> 'Unfortunately, no general principle has emerged, each case being determined in the particular circumstances according to what is just and fair.'

See too F R Ryder 'Payment of cheques after presentation of petition to wind up' 1980 JBL 189.

(45) 385 US 99 (1966) at 106-7.

(46) See further 236-7 above.

(47) See 237 above.

discretion as is conferred by s 341(2). In Gunn & Anor NNO v Barclays Bank DCO[48] it was argued that s 33 of the Insolvency Act confers a similarly wide discretion and Steyn CJ referred[49] to the 'uncertainty implicit in so wide a discretion' and to the fact that such a discretion enables 'facts unrelated to any defence recognised in law, and for that reason within a somewhat unpredictable range' to be proved.[50]

The consequence of this uncertainty is that it is not possible to compile a comprehensive list of every factor which may be relevant to the exercise of the court's discretion, nor is it possible to indicate precisely what weight is to be accorded to each factor. There is always the possibility of a new unforeseen factor weighing with the court in any particular case. Moreover, although a particular factor or combination of factors may be decisive in one case, the same factor or combination of factors may be outweighed by another factor or combination of factors in another case.

Each case must, of course, be decided on its own facts,[51] and although the tests enunciated by the courts in the decided cases are important guides as showing the way in which other courts have

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(48) 1962(3) SA 678 (A).

(49) At 685C and 686C.

(50) This uncertainty is well-illustrated specifically in relation to the continued operation by a company of its bank account by the decision in Re Gray's Inn Construction Co Ltd [1980] 1 All ER 814(CA) - see 238-40 above and 583-92 below.

(51) See eg Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor 1980(4) SA 669 (SWA) at 678E; Re Gray's Inn Construction Co Ltd supra at 820c; Re Steane's (Bournemouth) Ltd [1950] 1 All ER 21(Ch) at 25 A; Re Selmar (Pty) Ltd [1978] VR 531 at 534(5); Re Omnico Ltd (1976) 1 ACLR 381 (NSW) at 389(40).

exercised their discretion in particular cases, no court is bound by such tests as this would be to restrict the unfettered discretion conferred by the Act:

> 'Now it seems to me that when the Act is so express to provide a wide discretion, ... it is not advisable to lay down any rigid rules for guiding that discretion. I do not doubt that the rules enunciated by the Master of the Rolls in the present case are useful maxims in general, and that in general they reflect the point of view from which judges would regard an application for relief. But I think it ought to be distinctly understood that there may be cases in which any or all of them may be disregarded. If it were otherwise the free discretion given by the statute would be fettered by limitations which have nowhere been enacted. It is one thing to decide what is the true meaning of the language contained in an Act of Parliament. It is quite a different thing to place conditions upon a free discretion entrusted by statute to the Court where the conditions are not based upon statutory enactment at all. It is not safe, I think, to say that the Court must and will always insist upon certain things when the Act does not require them, and the facts of some unforeseen case may make the Court wish it had kept a free hand'

(per Earl Loreburn LC, in a different context, in Nyman & Anor v Rose[52]). A similar approach is to found in Re Atlas Truck Service (Pty) Ltd[53] specifically in relation to the Australian counterpart of s 341(2):

> 'The course of judicial decision makes it plain that the words "unless the Court otherwise orders" give the court a wide discretion which is not to be limited by any attempted classification of those cases which do, and those which do not, fall within them.'

Despite these difficulties and limitations it is possible to identify a number of general factors to which the courts may be

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(52) [1912] AC 623 (HLE) at 631 cited in Lawson & Kirk (Pty) Ltd v Phil Morkel Ltd 1953(3) SA 324(A) at 332B; R v Shimbakua 1955(1) SA 331 (SWA) at 333B-D; but cf Doherty v Allman & Dowden (1878) 3 App Cas 709 (HL1) at 728-9. See also Steyn Uiteg 216.

(53) (1974) 4 ACTR 19 at 20(20).

expected to have regard in any proceedings for validation of a disposition and to give an indication of the relative weight likely to be accorded to them. As Fox J recognised in the Atlas case:[54]

> 'In fact, later judgments have found guidance in earlier decisions, and some broad indicators have emerged.'

An endeavour will be made in what follows to identify these factors, and in (7) below[55] the application of these principles to the validation of the continued operation of a bank account will be considered.

(a) The object of s 341(2)

The object of s 341(2) and its counterparts elsewhere has been variously described in the cases.

In his classic judgment in In re Wiltshire Iron Company Ex p Pearson[56] Lord Cairns LJ said in relation to the English counterpart of s 341(2):

> 'This is a wholesome and necessary provision, to prevent, during the period which must elapse before a Petition can be heard, the improper alienation and dissipation of the property of a company in extremis.'

This approach is echoed by Snyman J in Lief NO v Western Credit (Africa) (Pty) Ltd[57] in which he described the mischief aimed at by the corresponding section in the 1926 Act as:

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(54) At 20(40).

(55) At 502-613 below.

(56) (1868) 3 Ch App 443 at 446-7.

(57) 1966 (3) SA 344(W) at 347B, quoted with approval in Vermeulen & Anor v C C Bauermeister (Edms) Bpk & Others 1982 (4) SA 159(T) at 161F-G.

'... a possible attempt by a dishonest company, or directors, or creditors or others, to snatch some unfair advantage during the period between the presentation of the petition for a winding-up order and the granting of that order by the Court.'

In Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor[58] Lichtenberg J said:

'In his judgment in the case of In re Civil Service and General Store Ltd (1887) 58 LT 220 at 221 CHITTY J said that the object of the English counterpart of s 341(2)] is that creditors should be paid pari passu. With this statement of the law I respectfully agree.'

In Tulsidas v Industrial Bank of Western India[59] the Bombay *Court of Appeal said:*

'[The] fundamental principle is that in a winding-up ... all unsecured creditors are to be paid pari passu, and further that the appropriate date for ascertaining their legal position is ... the date of the commencement of the winding-up. The object of this is of course to prevent the injustice and scrambles and intrigues which would arise if the company was to be at liberty to prefer one creditor to another.'

It is considered that 2 objects can be distilled out of the aforegoing:[60]

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(58) *1980(4) SA 669 (SWA) at 678G. See, too,* International Shipping Co (Pty) Ltd v Affinity (Pty) Ltd & Anor 1983(1) SA 79(C) at 87C - D; McPherson Liquidation 145.

(59) AIR 1931 Bombay 2 at 9. See also at 20.

(60) Although not mentioned in any of the cases, it is suggested that the section should be seen as also having a third object, namely to discourage creditors rushing at the first hint of financial difficulties to get in first thus perhaps precipitating a winding-up which would otherwise be avoided - see 232 n 14 above - but in any event such an object would not, it is thought, play any role in relation to validation and need therefore not be examined further here. It may also

(Footnote continued on next page)

(i) Avoidance of the dissipation of the company's assets

The object of the section is, firstly, to avoid the dissipation of the company's assets. For example, the disposal of an asset for less than its real value, the entering into of a contract on unfavourable terms and the disposal of an asset essential to enable the business of the company to be continued with a view to the sale of the business as a going concern will generally all be in conflict with this object of the section in that they all result in the dissipation of the company's assets.

On the other hand, the fact that it is an object of the section to avoid the dissipation of the company's assets, does not mean that, say, the disposal of an asset at less than its real value will never be validated; on the contrary, there may be other factors which render such a disposal beneficial to all concerned, eg the benefit to the company of having cash with which it can purchase essential stock may outweigh the loss resulting from the disposal of non-essential stock at less than its real value.

(ii) Concurrent creditors should benefit pari passu

The object of the section is, secondly, to ensure as far as possible that the concurrent creditors benefit pari passu; accordingly, any disposition which prefers one concurrent creditor over the others will generally be in conflict with the object of the section.

(Footnote continued from previous page)
be noted that the fact that these are the objects of the section does not mean that its effect is limited to dispositions which contravene these objects or that the court will automatically validate a disposition which does not contravene these objects - see eg Re Neath Harbour Smelting and Rolling Works (1887) 56 LT 727(Ch) in which the court declined to validate certain dispositions in order to protect the shareholders against the directors.

On the other hand, the fact that it is an object of the section that creditors should benefit pari passu does not mean that the courts will never validate the preferential discharge of a creditor's claim; on the contrary, there may be other considerations which outweigh this object eg a preferential payment may be necessary to avoid the cancellation of a valuable contract, the cancellation of which would entail greater loss than the loss arising from the preferential payment:

> 'Plainly, if the cases are right when they refer to the width of the discretion, it would be wrong to conclude that in all circumstances in which a payment is for a past debt, validation must necessarily be refused. There is no such absolute proposition. In a given case it might be for the benefit of creditors, as part of a larger scheme, that a particular debt be paid off .... It is nevertheless true, as a general proposition, that payment of a past debt, where there are no special circumstances, will not be validated; in general, it is the very type of transaction which the section is designed to nullify, or avoid'

(per Fox J in Re Atlas Truck Service (Pty) Ltd[61]).

A factor referred to in a number of cases is the presence or absence of the intention to give or get a preference.[62] However, the better view is, it is considered, that it is sufficient that a preference was in fact given for the court to refuse validation and that the intention to give or get a preference therefore does not take the matter further:

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(61) (1974) 4 ACTR 19 at 23(20-30). See too Re Gray's Inn Construction Co Ltd [1980] 1 All ER 814(CA) at 820d and 821c-e; In re A I Levy (Holdings) Ltd [1964] Ch 19; Tulsidas v Industrial Bank of Western India AIR 1931 Bombay 2 at 20.

(62) See eg the Gray's Inn case supra at 820h; In re Clifton Place Garage Ltd [1970] Ch 477(CA) at 491A; Re Llangennech Coal Company (1887) 56 LT 475(Ch) at 477; In re The Civil Service and General Store Ltd (1888) 57 LJ Ch 119. Cf Re J Le Lie Engineers Co Ltd [1976] 2 All ER 85(Ch) at 90f and 96a.

> 'To validate such preferential payment simply because first defendant did not know that it was being preferred when the payment was made to it, would, in my judgment, defeat the whole purpose of s 341 of the Companies Act ....'

(per Lichtenberg J in Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor[63]).

The object of pari passu distribution was accorded a new, additional significance in Re Gray's Inn Construction Co Ltd[64] in which a bank that had permitted a company to continue to operate its bank account during the period between presentation of a *winding-up application against* the company and the grant of the winding-up order, after the grant of the order sought validation of the continued operation of the account. The Court of Appeal held that the bank was vulnerable to a refusal to validate the payments made to third parties[65] because the bank had not instituted safeguards to ensure that preferential payments were not made to some creditors at the expense of the others.

No such onus had been imposed on a bank or any other person in any previous case and the view will be taken below[66] that the

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(63) 1980(4) SA 669(SWA) at 680D. See also the J Leslie case supra at 96a; In re All India Home Relief Insurance Co AIR 1939 Sind 196 at 199. Cf s 26 of the Insolvency Act which similarly operates independently of any intention to give or get a preference. The operation of s 29 is likewise partially independent of any intention to prefer.

(64) [1980] 1 All ER 814 (CA).

(65) Cf 375-91 above where the view is taken that payments by the company are in any event not dispositions by it.

(66) See 583-92 below.

imposition of such an onus on the bank leans too far in favour of the general body of creditors at the bank's expense and is in any event counter-productive because few banks may be expected to be willing to accept such an onus, with potentially serious consequences for a company against which a winding-up application is presented, whether well-founded or not.

The reported cases on s 341(2) *and* its counterparts elsewhere do not present a consistent picture in relation to the object that creditors should benefit pari passu, and in seeking to analyze these cases it is convenient to distinguish between cases involving the preferential discharge of a debt which arose prior to presentation and cases involving the preferential discharge of a debt which arose after presentation.

(A) Pre-presentation debts

Where the preferential discharge of, or giving of security for, a pre-presentation debt has been in issue the courts have in most cases[67] refused validation either expressly or implicitly on the

(67) Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor *1980(4) SA 669 (SWA) (mutually indebted parties exchanged* cheques instead of setting off claims and the disponee, unlike the company, only deposited the cheque in its favour after presentation); International Shipping Co (Pty) Ltd v Affinity (Pty) Ltd & Anor 1983 (1) SA 79(C) (notarial bondholder sought validation of its taking possession of mortgaged goods thereby elevating its rights to those of a secured creditor); In re *Liverpool Civil Service Association* Ex p Greenwood (1874) 9 Ch App 511 (petitioning creditor postponed petition on part payment of its claim and then proceeded when balance was not paid); In re John Daly & Co Ltd (1886) 19 LR (Ireland) 83 (repayment of a loan the auditor was prevailed upon to make in anticipation of the directors' resolving to issue certain

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grounds of the policy of pari passu distribution. However, in a number of cases the courts have in fact granted validation and the court's reasons for not applying the policy of pari passu distribution call for closer examination. The cases concerned may be broadly classified into the following categories on the basis of the reasons which the courts either expressly gave or which may be inferred from their judgments:

(01) Ex post facto applications in which the disponee was unaware at the time of receiving the preference that a winding-up application had been presented against the

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unissued debentures but which directors declined to do); In re The Civil Service and General Store Ltd (1888) 57 LJ Ch 119 (supplier insisted on part payment of existing claim before supplying essential goods against payment in cash - see further 569-73 below); Re J Leslie Engineers Co Ltd [1976] 2 All ER 85 (Ch) (creditor pressed for payment - see further 573-4 below); Re Dittmer Gold Mines Ltd (No 3) [1954] SR (Qld) 275 (security for a pre-presentation debt); Re Atlas Truck Service (Pty) Ltd (1974) 4 ACTR 19 (payment of pre-presentation debt to creditor who was unaware of presentation); Tulsidas v Industrial Bank of Western India AIR 1931 Bombay 2 (security given to gain time for consideration of scheme of arrangement or sale of business as a going concern - see further 573-4 below); In re All India Home Relief Insurance Co AIR 1939 Sind 196 (insurance company continued to make payments to policyholders); Official Liquidators Gorakhpur Electric Supply Co Ltd v Siemens (India) Ltd AIR 1940 Allahabad 514 (payment to supplier of essential parts - see further 569-73 below); Ram Lal v Official Liquidator, Benares Bank Ltd AIR 1942 Allahabad 141 (the nature of a claim was changed so that it became preferent); Vegetols Ltd (in liq) (1968) 38 Comp Cas 58 (And P) (payment of a pre-presentation debt after company had ceased trading). Cf too Clarke v West Calder Oil Company (1882) 9 R 1017 at 1031-3 (delivery of pledged articles perfecting security).

company.[68] There is, however, no uniformity among the cases that *absence of knowledge of the presentation* will entitle the disponee to validation,[69] and the view will be taken below[70] that the absence of such knowledge is *not relevant to the question* of whether or not the preferential discharge or securing of a pre-presentation debt should be validated;

(02) Ex post facto applications in which the preference was given in good faith and the ordinary course of business.[71] Again, however, there is no uniformity

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(68) Re Gray's Inn Construction Co Ltd *[1980]* 1 All *ER 814 (CA)* (deposits to overdrawn bank account, but see 583-92 below where it is questioned whether the court would have reached this conclusion had the only relevant facts been the *preferential* payments and the absence of knowledge on the disponee's part that it was being preferred); The National Bank's Case (1873) 28 LT (Eur Arb) 92. Cf, too, In re Oriental Bank Corporation Ex p Guillemin (1885) 28 ChD 634 at 642 (payments by bank against which winding-up petition had been presented); Re T W Construction Ltd *[1954]* 1 All ER 744(Ch) at 748E-F (deposit to overdrawn bank account - see further 595-6 below).

(69) See the J Leslie case supra at 95f; the Atlas case supra at 23(35)-24(10) and the All India case supra at *199*.

(70) See 536-41 below.

(71) Re Llangennech Coal Company (1887) 56 LT 475 (Ch) (delivery of goods to railway company which goods thereupon become subject to the company's lien); Re T W Construction Ltd [1954] 1 All ER 744(Ch) (deposit to overdrawn bank account - see further 595-6 below). Cf Re The Northfield Iron and Steel Company Ltd *(1886)* 14 LT *695 (in which the court may have overlooked the* English counterpart of s 341(2) in holding that the delivery of goods after presentation but before the winding-up order by the provisional liquidator to a railway company was not void even though the goods became subject to a lien both for the

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among the cases that this is a good ground for validation[72] and the view will likewise be taken below[73] that it is not;

(03) An ex post facto application in which the preference was given to secure further supplies essential for the company's business.[74] Yet again, however, there is no uniformity among the cases that this is a good ground for validation[75] and the view will likewise be taken below[76] that it is not, except in advance applications for validation;

(04) Ex post facto applications in which it appears that the court was swayed by the fact that the disponee's motive was to benefit the company rather than the pursuit of personal gain, although the reasons actually given by the courts concerned were the same as those referred to in the second

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railway company's claim as at presentation and for the freight charges in respect of the good themselves). Cf, too, The Oriental Bank case supra; Re Norman King and Co (Pty) Ltd (1960) 60 SR (NSW) 98 at 104 (the giving of security in consideration of further credit being extended); M N Ramaswami Ayyar and Co (P) Ltd v The Joint Official Liquidators of the Nurani Union Bank Ltd (1969) 1 Comp LJ 248(Mad).

(72) Most of the cases in which validation was refused would probably have met these criteria - see eg the Herrigel, Liverpool, J Leslie, Atlas and Tulsidas cases supra.

(73) See 526-54 below.

(74) Albion Reid (SA) (Pty) Ltd v Baron Holdings (Pty) Ltd (1973) 7 SASR 564 (security given both for existing debt and for future debt).

(75) See the Civil Service and Gorakhpur cases supra.

(76) See 569-73 below.

category above.[77] The disponee's motivation as a ground for validation is examined below,[78] and it suffices to note here that the conclusion reached there is that if the *disponee's motive* was to benefit the company this is a factor favouring validation but that the weight to be accorded to it will depend on the circumstances;

(05) An advance application in which the court *validated* the giving of a preference which was necessary to avoid the cancellation of a valuable contract.[79] Clearly if the benefit flowing from the preference exceeds the prejudice flowing from the preference this is a good ground for validation in an advance application. (As will be seen below,[80] however, the position is more complex in an ex post facto application);

(06) Cases in which the company was able to pay its debts.[81] These cases, however, have no relevance to s 341(2) which,

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(77) In re International Life Assurance Society Gibbs and West's Case (1870) 10 Eq 312 (directors caused company to give security, and gave their personal suretyships, to bankers to gain time to sell business and they would have been the ones to suffer if validation had been refused - see further 542-3 below); Re Steane's (Bournemouth) Ltd [1950] 1 All ER 21 (Ch) (director agreed to lend money needed by company against security but because of company's pressing need advanced portion of the money before the security was perfected - see further 543-4 below).

(78) See 541-5 below.

(79) In re A L Levy (Holdings) Ltd [1964] Ch 19. Cf, too, Re Gray's Inn Construction Co Ltd [1980] 1 All ER 814 (CA) at 821d.

(80) See 566-9 below.

(81) Re Operator Control Cabs Ltd [illegible] All ER 657(Ch); Re Argentum Reductions (UK) Ltd [illegible] All ER 608 (Ch); Re Burton & Deakin Ltd [1977] 1 All ER 659 (Ch).

unlike its counterparts in England, Australia and India, only applies to companies which are unable to pay their debts.

(B) Post-presentation debts

Does the object of pari passu distribution apply to post-presentation debts?

Until recently the courts stated simply that the creditors should benefit pari passu without drawing any distinction between pre- and post-presentation creditors.(82) It is noteworthy, however, that all the references to the policy of pari passu distribution in the cases concerned related to the discharge of pre-presentation debts. This may be illustrated by the case of In re The Civil Service and General Store Ltd(83) in which the supplier of goods necessary for the company's business had refused to supply further goods unless a part payment on account of its existing claim was made. Chitty J refused, in an ex post facto application, to validate the part payment on the express ground that to do so would offend against the object that creditors should be paid pari passu, but he did validate the payments made for goods supplied after presentation without considering whether such payments did not possibly also offend against this object.

(82) See eg Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor 1980 (4) SA 669 (SWA) at 678A; In re Liverpool Civil Service Association Ex p Groenwood (1874) 9 Ch App 511 at 512; In re The Civil Service and General Store Ltd (1888) 57 LJ Ch 119 at 120; Millar v The National Bank of Scotland Ltd & Others (1891) 28 ScLR 884 at 889; Re J Leslie Engineers Co Ltd [1976] 2 All ER 85 (Ch) at 92f; Re Dittmer Gold Mines Ltd (No 3) [1964] SR (Qld) 275 at 282; Tulsidas v Industrial Bank of Western India AIR 1931 Bombay 2 at 20 but cf at 9.

(83) Supra.

The approach of dealing with applications for the validation of the payment of post-presentation debts without reference to the policy of pari passu distribution had its origin in In re Wiltshire Iron Company Ex p Pearson.(84) After presentation a customer of the company ordered and paid in advance for iron to be delivered within 30 days. Thereafter the company delivered the iron and the Court of Appeal validated the delivery saying:

> '...where a company actually trading, which it is the interest of every one to preserve, and ultimately to sell, as a going concern, is made the object of a winding-up Petition, which may fail or may succeed, if it were to be supposed that transactions in the ordinary course of its current trade, bonâ fide entered into and completed, would be avoided, and would not, in the discretion given to the Court, be maintained, the result would be that the presentation of a Petition, groundless or well-founded, would, ipso facto, paralyze the trade of the company, and great injury, without any counterbal[illegible] of advantage, would be done to those interested in the [illegible] of the company.'

A distinction between pre- and post-presentation debts was clearly drawn for the first time by Buckley LJ in delivering the judgment of the Court of Appeal in the recent case of of Re Gray's Inn Construction Co Ltd:(85)

> 'It is a basic concept of our law governing the liquidation of insolvent estates, whether in bankruptcy or under the Companies Acts, that the free assets of the insolvent at the commencement of the liquidation shall be distributed rateably amongst the insolvent's unsecured creditors as at that date. In bankruptcy this is achieved by the relation of the trustee's title to the bankrupt's assets back to the commencement of the bankruptcy, in a company's compulsory winding up it is achieved by s 227(86) ....
>
> 'In a number of cases reference has been made to the relevance of the policy of ensuring rateable distribution of the assets ....

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(84) (1868) 3 Ch App 443 at 447.

(85) [1980] 1 All ER 814(CA) at 819g-h, 820j and 821b.

(86) The English counterpart of s 341(2).

> 'But, although that policy might disincline the court to ratify any transaction which involved preferring a pre-liquidation[87] creditor, it has no relevance to a transaction which is entirely post-liquidation, as for instance a sale of an asset at its full market value after presentation of a petition. Such a transaction involves no dissipation of the company's assets, for it does not reduce the value of those assets.'

Is it correct that the object of pari passu distribution has no relevance to post-presentation creditors? If, for example, a company pays one supplier for goods supplied after presentation while not paying another supplier in identical circumstances, would the court validate the payment to the first supplier? Despite what Buckley LJ says, it is, with respect, difficult to accept that it is no part of the policy of s 341(2) to ensure that post-presentation creditors also benefit pari passu.

It appears that the approach in the Wiltshire case and the cases based on it is founded on the implied assumption that it is necessary that the courts should validate the discharge of post-presentation debts in order to avoid the mere presentation of a winding-up application, whether well-founded or not, having the effect of paralysing the company's business. This assumption is examined below[88] and the conclusion reached there is that the assumption is not valid and that what is required to avoid the paralysis of the company's business is essentially that validation should be granted where the disponee relies on the discharge by the company of a debt in himself discharging, or undertaking and discharging, a debt to the company. This, moreover, applies equally to the discharge of pre- and post-presentation debts so that it is not a basis for distinguishing between pre- and post-presentation creditors.

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(87) Buckley LJ uses the expression 'pre-liquidation' for 'pre-presentation'.

(88) See 552-4 below.

Buckley LJ's reasoning in the Gray's Inn case is, with respect, equally unconvincing. He states that the policy of pari passu distribution has no relevance to a transaction which is entirely post-presentation such as the sale of an asset at its full market value, because such a transaction does not involve a dissipation of the company's assets. Although it is true that such a transaction does not involve a dissipation of the company's assets it appears to be a non-sequitur to infer from this fact that the other party to the transaction is entitled to be preferred over the other creditors whose claims will in most cases also have arisen out of transactions which did not involve any dissipation of the company's assets. This approach, it is suggested, confuses the 2 objects of the section: to avoid the dissipation of the company's assets and to ensure that creditors benefit pari passu.

Is there, then, any reason why those post-presentation creditors who were fortunate enough to receive the preferential discharge of their claims should be permitted to retain the preferences received by them at the expense of the other creditors? The answer is, it is thought, in the negative. Justice and fairness as between the creditors require that they should all benefit pari passu in the absence of good reason entitling a creditor to be preferred, and no good reason exists for exempting the post-presentation creditors as a group from this policy.

Could it be argued that the post-presentation creditors should be preferred over pre-presentation creditors on analogy with post-liquidation creditors? The answer is, it is thought, that s 341(2) is not susceptible of this interpretation. The court could validate all payments made to post-presentation creditors thus effectively ensuring them a preference but it could not order the preferential payment of the other post-presentation creditors who had not been paid,(89) and this, as already pointed out, would be

(89) See eg In re Wiltshire Iron Company Ex p Pearson (1868) 3 Ch App 443.

inequitable as between the post-presentation creditors inter se. Moreover, if the court declines to validate the payments to the *post-presentation creditors*, the benefit arising from such non-validation accrues not to the other post-presentation creditors only, but to all the creditors. The inescapable conclusion is, it is suggested, that the object of s 341(2) must be seen as the pari passu ranking of all the creditors.

In nearly all the cases in which the discharge of a *post-presentation debt has* been in issue the courts have granted validation, although there are exceptions.(90) The cases in which validation was granted may be broadly classified into a number of categories:

(01) The first category, which includes most of the cases, consists of ex post facto applications in which - as in the *Wiltshire case* - validation was granted because the transaction was entered into bona fide and in the ordinary

(90) The most important exception, albeit only a partial exception, is *Re Gray's Inn Construction Co Ltd* [1980] 1 All ER 814(CA). This was an ex post facto application in which the court held that it was not sufficient that a bank which sought validation of the continued operation by a company customer of its account had taken steps to ensure that only payments in the ordinary course of the company's business were made from the account; the bank should also have taken steps to ensure that *no preferential payments* were made to some creditors at the expense of the other creditors and that the company only continued to operate its account as long as it traded at a profit. The court accordingly refused to validate deposits equal to the loss in fact incurred by the company and also held that the bank was vulnerable to a refusal to validate payments out of the account to the extent they preferred *pre-presentation creditors*. Otherwise the court validated all transactions on the account. The validity of imposing such an onus on the bank is examined at 583-92 below and the view taken there is that to do so is to go too far towards protecting the creditors at the expense of the disponee. Validation was also refused in In re All India Home Relief Insurance Co AIR 1939 Sind 196 (insurance company continued to *make payments to policyholders*); Anhadra Bank Ltd v Narayana Rao AIR 1955 Madras 247 (security for new banking facilities).

course of business[91] to keep the company's business going, without discussion of whether it was just and fair to the other creditors that the creditor concerned should be preferred. It is useful, however, to break this category down into 2 sub-categories:

- The first of these sub-categories consists of cases in which the creditor simply extended credit to the company and thereafter received the preferential discharge of its claim.[92]

- The second of these sub-categories consists of cases in which the creditor relied on the discharge by the company of its obligations in himself discharging, or

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(91) Not all the cases involved transactions in the ordinary course of business - see eg the Sen Gupta and Selmar cases infra.

(92) The Wiltshire case supra; Re T W Construction Ltd [1954] 1 All ER 744 (Ch) (deposit by company to bank account effecting repayment of pre- and post-presentation withdrawals - see further 595-6 below); Re Selmar (Pty) Ltd [1978] VR 531 (passing of ownership pursuant to sale by company. The court appears to have also been influenced by essentially compassionate considerations - see 562-3 below); Khanna v Ghosh 1976 MhLJ 150 (payment by bank of draft purchased from it after presentation of winding-up petition against bank). Cf, too, In re Oriental Bank Corporation Ex p Guillemin (1885) 28 ChD 634 at 642 (the court assumed that payment by a bank bona fide and in the ordinary course of business after presentation of a winding-up petition against it would qualify for validation); Official Liquidators Gorakhpur Electric Supply Co Ltd v Siemens (India) Ltd AIR 1940 Allahabad 514 (the court refused validation of a payment made to a supplier on account of its pre-presentation claim for the purpose of securing the company's source of supply of essential parts, but indicated that had any parts in fact been supplied it would have validated payment of the purchase price). These cases may be contrasted with the All India case supra in which validation was refused.

undertaking and discharging, a debt to the company.[93]

This distinction is examined below[94] and the view taken there is that it is only in cases falling into the second sub-category that validation should be granted.

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(93) Re Llangennech Coal Company (1887) 56 LT 475 (Ch) (the court validated delivery of goods by the company to a railway company in whose hands they became subject to a lien for the freight charges ie in effect the company gave security for the payment of the freight charges and the court validated the giving of the security); In re The Civil Service and General Store Ltd (1888) 57 LJ Ch 119 (supplier was only prepared to supply goods against payment in cash and the court validated the payment); In re Park Ward and Company Ltd [1926] Ch 828 (giving of security for a new loan); Re Steane's (Bournemouth) Ltd [1950] 1 All ER 21 (Ch) (giving of security for a new loan); In re Clifton Place Garage Ltd [1970] Ch 477(CA) (parent company acted as banker to company making payments on behalf of the company and receiving the company's daily takings in return. The court validated the repayments constituted by the handing over of the daily takings - see further 597-600 below); Albion Reid (SA) (Pty) Ltd v Baron Holdings (Pty) Ltd (1973) 7 SASR 564 (giving of security for new credit, *and giving of security in* substitucion for existing security); Re Omnico Ltd (1976) 1 ACLR 381 (NSW) (giving of security for loan to pay existing secured debts); Re J Sen Gupta Private Ltd AIR 1962 Cal 405 (delivery by company of truck against payment in cash). Cf Re The Northfield Iron and Steel Company Ltd (1866) 14 LT 695 in which the court may have overlooked the English counterpart of *s 341(2) in holding that the* delivery of goods between presentation and the grant of the winding-up order by the provisional liquidator to a railway company was not void even though the goods became subject to a lien both for the railway company's claim as at presentation and for the freight charges in respect of the goods themselves. Cf too Re Norman King and Co (Pty) Ltd (1960) 60 SR (NSW) 98 (director passed mortgage *bond over property held* by him as nominee for company as security for new credit granted to the company. The court held that no disposition had occurred but indicated that if one had it might well have qualified for validation). These cases may be contrasted with the Anhadra case supra in which validation was refused.

(94) *See 557-60 below.*

(02) The second category consists of an advance application in which the court validated the sale of a lease which was subject to forfeiture in the event of winding-up.[95] Clearly, where validation is in the interests of all concerned it may be expected to be granted as a matter of course.[96]

(03) The third category consists of cases in which the company was able to pay its debts.[97] These cases, however, have no relevance to s 341(2) which, unlike its counterparts elsewhere, only applies to companies which are unable to pay their debts.

(b) Benefit of the interested parties

Where validation is in the interests of all the interested parties the court may obviously be expected to readily grant a validation order.

Where validation would be in the interests of one or more of the interested parties but not of the others the court will weigh up the conflicting interests of the parties in reaching its decision:

> 'As was pointed out by SACHS LJ in the Clifton Place Garage case supra[98] at 492C, the Court, in assessing what is just and fair, must, inter alia, of necessity strike some balance upon looking at what is fair vis-à-vis the applicant [the disponee] as well as what is fair vis-à-vis the creditors of the company in liquidation'

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(95) In re A I Levy (Holdings) Ltd [1964] Ch 19. Cf, too, the Gray's Inn case supra at 821d. See further 566-9 below.

(96) See the next section.

(97) Re Operator Control Cabs Ltd [1970] 3 All ER 657 (Ch); Re Argentum Reductions (UK) Ltd [1975] 1 All ER 608(Ch); Re Burton & Deakin Ltd [1977] 1 All ER 631(Ch).

(98) [1970] Ch 477 (CA).

(per Lichtenberg J in Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor[99]). This was said in relation to an ex post facto application for validation, but as will be seen below a similar balancing exercise is also necessary in the case of advance applications, although the parties whose interests are to be weighed, and the factors that are to be taken into account, in carrying out the balancing exercise in the 2 situations are not identical.

The fact that a transaction as a whole is in the interests of the interested parties does not necessarily mean that validation of the discharge by the company of its obligations pursuant to the transaction will necessarily also be in the interests of the interested parties. For example, the purchase by the company of stock needed to continue its business may well be in the interests of all concerned, but if the stock is purchased on credit from various suppliers and the company pays some of the suppliers and not others, validation of the payments to the suppliers who received the preferential payments would not, it is considered, be in the interests of the general body of creditors.

Many illustrations of transactions which are likely to be in the interests of all concerned are to be found in the cases. These transactions may be broadly classified into the following categories:

- transactions aimed at the preservation of the company's business for sale as a going concern;[100]

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(99) 1980 (4) SA 669 (SWA) at 678H-679A. See too Re Selmar (Pty) Ltd [1978] VR 531 at 534 (15-20).

(100) See eg In re Wiltshire Iron Company Ex p Pearson (1868) 3 Ch App 443 at 447; In re Park Ward and Company Ltd [1926] Ch 828 at 831; In re Clifton Place Garage Ltd [1970] Ch 477 (CA); Re Gray's Inn Construction Co Ltd [1980] 1 All ER 814 (CA) at 819h-820a; Re Omnico Ltd (1976) 1 ACLR 381 (NSW) at 390;
(Footnote continued on next page)

- transactions aimed at the sale of the company's assets, especially stock, at a good price;(101)

- transactions aimed at the preservation of, or increase in, the company's assets;(102)

- transactions aimed at the completion by the company of a contract or project;(103)

- transactions aimed at the making by the company of a profit or the minimising of a loss;(104)

- transactions aimed at the restoration of the company to solvency;(105)

(Footnote continued from previous page)
Tulsidas v Industrial Bank of Western India AIR 1931 Bombay 2 at 5. Cf too Re J Sen Gupta Private Ltd AIR 1962 Cal 405; Ram Lal v Official Liquidator, Benares Bank Ltd AIR 1942 Allahabad 141. All of these cases were *ex post facto applications* but the principle is all the more applicable to advance applications. The cases referred to in the following notes were also ex post facto applications, except for the A I Levy and Carden cases.

(101) See eg the Gray's Inn case supra at 819j and 821a.

(102) See eg the Gray's Inn case supra at 821c; In re A I Levy (Holdings) Ltd [1964] Ch 19; Carden v The Albert Palace Association (1887) 56 LJ Ch 166; Howard (Sunbury) Ltd 1948, unreported, referred to in Re Steane's (Bournemouth) Ltd [1950] 1 All ER 21 (Ch) at 24.

(103) See eg the Gray's Inn case *supra at 819j-820a*; Albion Reid (SA) (Pty) Ltd v Baron Holdings (Pty) Ltd (1973) 7 SASR 564 at 568-9.

(104) See eg Re Atlas Truck Service (Pty) Ltd (1974) 4 ACTR 19 at 23 (45-50); Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor 1980(4) SA 669 (SWA) at 680E.

(105) See eg In re International Life Assurance Society Gibbs and West's Case (1870) 10 Eq 312; Re Selmar (Pty) Ltd [1978] VR 531 at 534 (50); Re J Leslie Engineers Co Ltd [1976] 2 All ER 85 (Ch) at 95 g-h; Herrigel's case supra at 679G.

- transactions aimed at the avoidance of claims for damages against the company.[106]

Because the considerations applicable to advance and ex post facto applications are significantly different it is convenient to deal with the 2 types of application separately.

(i) Advance applications

Where it appears in an advance application for validation that a proposed disposition will be in the interests of all the interested parties, validation may obviously be expected to be granted.[107]

Where the proposed disposition is in the interests of some of the interested parties but not of others the court will weigh the conflicting interests of the interested parties. Who are these parties? The answer is, it is thought, essentially the creditors and the shareholders.

Clearly, the creditors are interested parties:

> '... this being a case in which it appears to me to be manifest that the transaction is one which must benefit the unsecured creditors of the company if in due course a winding-up order is made .... I will make an order the consequence of which will be that the company will be in a position to effect the sale of these leasehold premises without any fear of the purchaser finding that the transaction is avoided hereafter'

(per Buckley J in In re A I Levy (Holdings) Ltd[108]).

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(106) Tulsidas v Industrial Bank of Western India AIR 1931 Bombay 2 at 24.

(107) In re A I Levy (Holdings) Ltd [1964] Ch 19 at 28; Re Falkiner Chains (Pty) Ltd (1981) 6 ACLR 94 (Qld).

(108) [1964] Ch 19 at 28. See too the Falkiner case supra at 96.

The shareholders' interest arises from the fact that at the time an advance application for validation is made there is no certainty that the winding-up application will succeed and should it prove that the winding-up application is unfounded great harm may have been done to the company by a refusal to validate. If the courts were to always disregard the shareholders' interests in favour of the creditors' interests the mere presentation of a winding-up application could seriously harm the company, and it is considered that justice and fairness towards the shareholders requires that their interests should also be taken into account.

In several English cases[109] dealing with companies which were able to pay their debts - the English counterpart of s 341(2) is not limited to companies which are unable to pay their debts - the court had regard to the interests of the shareholders. As Megarry J said in Re Argentum Reductions (UK) Ltd[110] (in dealing with the question of locus standi to apply for validation):

> 'To a shareholder ... it may be a matter of great concern, as closely affecting the value of his shares, that certain transactions should be saved from being invalidated.'

The question of whether the shareholders' interests are relevant where the company is unable to pay its debts has, however, not arisen directly in any of the cases on s 341(2) and its counterparts in England, Australia and India, although there is a glancing allusion to the question in Re Pacific Coast Fisheries (Pty) Ltd[111] in which the court said :

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(109) Re Argentum Reductions (UK) Ltd [1975] 1 All ER 608 (Ch) at 611f; Re Burton & Deakin Ltd [1977] 1 All ER 631(Ch) at 636e; Re Operator Control Cabs Ltd [1970] 3 All ER 657 (Ch) at 658g.

(110) Supra at 611f.

(111) (1980) 5 ACLR 354 (Qld) at 356.

> 'It is, I *think*, apparent that in proceedings of this sort there is an onus on the person who seeks to uphold a transaction which might be otherwise avoided to point to surrounding circumstances as indicating advantage to the creditors generally, and it may be to the contributories.'

Nevertheless, it is thought that the shareholders' interests are relevant in any case in which there is no certainty that the winding-up application will succeed.

Generally, if a transaction is in the interests of the *shareholders* it will *also* be *in* the interests of the creditors. However, this will not always be so. For example, if a company is continuing to trade at a loss it may be in the interests of creditors to cease trading, while from the shareholders' point of view they may have nothing further to lose and continued trading may entail the possibility of the corner being turned with the company being restored to profitability.

Because the shareholders' interest arises from the uncertainty regarding the outcome of the winding-up application an important consideration in weighing up the conflicting interests of the creditors and shareholders is, it is suggested, the prospects of success in the winding-up application. If, for example, the grant of a winding-up order appears virtually inevitable the court is *unlikely to attach much* weight to the shareholders' interests, whereas the reverse is likely to be the case if the winding-up application's prospects of success appear tenuous.

The real difficulty arises where there is no clear indication as to the prospects of success in the winding-up application:

> 'Templeman J said in the course of his judgment:
>
> > "This present case, however, inevitably involves consideration of the dilemma which confronts a bank when a company requests the continuation of banking facilities after the presentation of a winding-up petition, but there are no plain indications on the one hand that the petition is *misconceived or on the other hand* that the company ought to be immobilised immediately."

> 'He went on to say that a bank faced with such a request should weigh the likely benefits and dangers of the company continuing in business against the benefits and losses which may be the consequences of an immediate cessation of business ....
>
> 'In each case, I think, the court must necessarily carry out a balancing exercise of the kind envisaged by Templeman J'

(per Buckley LJ in Re Gray's Inn Construction Co Ltd[112]). The validation application in question was made ex post facto but had it been made in advance the dilemma referred to by Templeman J would have confronted the court. Whose interests should take precedence in this situation? The answer is, it is thought, that as long as there is no clear indication that the winding-up application is likely to succeed the court should rather err in favour of the shareholders than the creditors,[113] although sometimes, no doubt, the potential prejudice to the creditors will be of such an order that the court will conclude that the creditors' interests should take precedence over the shareholders' interests despite the fact that the winding-up application may be unfounded.

It would seem, moreover, that it is not only the interests of the creditors and the shareholders that will be taken into account

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(112) [1980] 1 All ER 814(CA) at 819b-c and 820c.

(113) This may have been in the mind of Lucas SPJ who, in delivering the judgment of the Full Court in Re Falkiner Chains (Pty) Ltd (1981) 6 ACLR 94 (Qld) at 96, said:

> 'It was said on behalf of the appellants that the learned judge failed to give sufficient attention to the nature of the opposition which was put forward against the orders sought, but the order shows that the only opposition came from the petitioning creditor and from the provisional liquidators appointed on the day of the presentation of the petition.
>
> 'The position was therefore that the only opposition came from those persons in circumstances in which a winding up order might never be made.'

but that regard may also be had to the interests of other persons such as the company's employees or even the community at large. This appears to have been in Vaisey J's mind in re Steane's (Bournemouth) Ltd[114] in which the company carried on a substantial business of making and erecting pre-fabricated houses and Vaisey J remarked:

> 'That, I suppose, may fairly be regarded as work of national importance.'[115]

What weight the courts will accord to the interests of such other persons remains to be seen, but the ongoing growth of social consciousness which has characterised the past century and shows no sign of abating may, it is suggested, be expected to be reflected in decisions of the courts in this field.

No mention has been made thus far of the disponee's interests. Are the disponee's interests not relevant? The answer is, it is thought, that in advance applications they are not. Where the proposed disposition is the conclusion and implementation of a new transaction it is difficult to see how the disponee's interests could be relevant at all, and where the proposed disposition is the discharge of a pre-presentation debt it would seem that the disponee's interests could only be relevant if regard may properly be had to compassionate considerations, and it is doubted whether compassionate considerations are an appropriate criterion for the exercise by the court of its discretion.[116] A possible exception

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(114) [1950] 1 All ER 21 (Ch) at 23A.

(115) The court may also have had the broader interests of the community in mind in Albion Reid (SA) (Pty) Ltd v Baron Holdings (Pty) Ltd (1973) 7 SASR 564 at 568 where reference is made to the 'unconscionable use of economic power'.

(116) See 562-3 below.

is salaries and wages,[117] although even in the case of salaries and wages it is thought that the better view is that the court's discretion should not be used to indirectly accord them a greater preference than they would otherwise enjoy. Payment of the salaries and wages may of course also be in the interests of the shareholders and creditors, but where payment would be in the interests of the employees alone it is doubted whether validation would be appropriate, save, perhaps, to the extent of the preference they would in any event enjoy.

A point that must be borne in mind in advance applications is that creditors will generally not be represented before the court either directly or through a liquidator.[118] It follows, it is thought, that the courts may be expected to be astute to protect the creditors' interests. This is likely to be of particular importance where validation is sought of future transactions generally eg all transactions necessary for the continued conduct of the company's business. In such a case the court may be expected to lay down appropriate conditions to protect the creditors' interests, such as:[119]

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(117) '... in my judgment, the court should extend indulgence to any disposition by a company honestly designed to ensure that its employees are paid their wages or which was made to enable it to carry on its business and perhaps turn the corner ...'

(per Phillimore LJ in In re Clifton Place Garage Ltd [1970] Ch 477(CA) at 494D).

(118) Cf the discussion of this question at 479-85 above.

(119) See generally Re Gray's Inn Construction Co Ltd [1980] 1 All ER 814 (CA) in which the court held in an ex post facto application for validation of the continued operation by the company of its bank account that similar safeguards should have been instituted by the bank. The placing of this onus on

(Footnote continued on next page)

- That only transactions in the ordinary course of the company's business are to be entered into;

- That preferential payments are not to be made to some creditors and not others, except in proper cases. (What will constitute a proper case is examined in the succeeding sections);

- That the business is only to be continued if, and for as long as, the assumptions on which the court's order was based prove to be correct. If, for example, the company satisfies the court that its continued trading is likely to produce a profit or at least to break even but in fact it becomes clear soon after the grant of the order that substantial losses are being incurred it may be inappropriate that the court's order should remain effective.

In the nature of the conditions likely to be laid down the court may well require that their observance be monitored by an independent person such as a chartered accountant.(120)

(ii) Ex post facto applications

In an ex post facto application for validation the court is essentially concerned with weighing up the interests of the

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(Footnote continued from previous page)
the bank is criticised at 583-92 below but the need for safeguards is clear. But see Re KVE Homes (Pty) Ltd (1979) 4 ACLR 47 (NSW) and Re Falkiner Chains (Pty) Ltd (1981) 6 ACLR 94 (Qld), both of which were advance applications for validation of the continued conduct of the company's business and in neither of which did the court stipulate any such safeguards.

(120) Cf D B Evans (Bilston) Ltd v Barclays Bank Ltd (1961) Legal Decisions Affecting Bankers 283 (CA) at 283-4, referred to in Paget Banking 247; F R Ryder 'Payment of cheques after presentation of petition to wind up' 1980 JBL 189 at 189-90.

creditors and the disponee, not the interests of the shareholders and the creditors. The shareholders have largely ceased to have any interest in the question of whether or not the disposition is validated because their interest was the avoidance of a winding-up if there was a possibility of the company's being restored to profitability but this possibility has been excluded by the grant of the winding-up order.(121)

In weighing up the conflicting interests of the creditors and the disponee the first question to arise is, it is considered, whether or not validation is in the interests of the creditors. If it is, validation will be granted. If it is not, a second question arises, namely: Do considerations of justice and fairness vis-à-vis the disponee dictate that the disposition should be validated despite the fact that validation is not in the interests of the creditors? If the answer is in the affirmative the disposition will be validated; otherwise validation will be refused.

The factors which may dictate that a disposition should be validated despite the fact that validation is not in the interests of creditors will be examined in the following sections, but it may be noted at this stage that it does not, it is believed, follow that because a disposition would have been validated had application been made in advance it will automatically be validated where application is made ex post facto. This may be illustrated by the case of a supplier who is the only available supplier of goods essential for the company's business and who is only prepared to continue to

(121) The position may be different where the shareholders' shares are not fully paid up but this is of only limited significance in this country in view of the fact that it has not been possible to issue partly paid up shares since 1 January 1974 - s 92 of the 1973 Act. Even where there are no partly paid up shares the shareholders' interests may not have ceased altogether eg because there may still be a possibility of the company's being discharged from winding-up in that the company is not in fact insolvent or a compromise may be effected with creditors.

supply the company provided that his existing claim is paid and future deliveries are paid for in cash against delivery. In an advance application the court may be compelled to validate the preferential payment of the existing claim in order to avoid the paralysis of the company's business, but in an ex post facto application this has ceased to be a consideration and the court may, it is thought, be expected to be reluctant to validate the preferential payment.(122) Put in another way, in an advance application if a disposition is in the interests of creditors validation will also be in the interests of creditors, but in an ex post facto application if a disposition was in the interests of creditors it does not necessarily follow that validation will be in the interests of creditors.

It has already been mentioned that in advance applications the interests of other persons such as the company's employees or the community at large may have some influence on the court's decision. In ex post facto applications, however, the interests of the community at large take on a special significance. If a person dealing with a company against which a winding-up application has been presented cannot rely on transactions in the ordinary course of business being validated the effect of the presentation of the winding-up application, whether well-founded or not, may well be to paralyse the company's business. There is, therefore much to be said for a general policy of validation of such transactions in the interests of other companies against which winding-up applications may in the future be presented, even though in the case of the company in question this consideration has ceased to be relevant in that the company either has or has not succeeded in avoiding the paralysis of its business. This is dealt with more fully below.(123)

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(122) See further 569-73 below.

(123) See 549-52 below.

(c) Good faith

Probably the most commonly referred to criteria for validation is good faith:

> '... each case must be dealt with on its own facts and particular circumstances (special regard being had to the question of good faith and honest intention of the persons concerned) ...'

(per Lichtenberg J in Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor[124] quoting Vaisey J in Re Steane's (Bournemouth) Ltd[125]).

Over a century ago Lord Penzance[126] pointed out that the danger of an unfettered discretion is that it is likely to be 'the refuge of vagueness in decision and the harbour of half-formed thought'. Although this was said in a different context, the history of judicial decision in relation to s 341(2) and its counterparts elsewhere with respect amplify justifies the fears expressed by Lord Penzance, and in no respect is this more evident than in the case of the good faith test. Although it is probably the most referred to criterion for validation, in no case has any attempt been made to define the precise nature of the required good faith or by whom and

(124) 1980 (4) SA 669 (SWA) at 678E. See also Commercial Grain Producers Association v Tobacco Sales Ltd 1983(1) SA 826 (ZS) at 830H.

(125) [1950] 1 All ER 21 (Ch) at 25A. Almost all the cases dealing with validation under the English, Australian and Indian counterparts of s 341(2) refer to good faith; accordingly, little purpose would be served by listing all these cases. The more important cases are dealt with below. It is, however, perhaps significant that there is only limited mention of good faith in the recent Court of Appeal decision in Re Gray's Inn Construction Co Ltd [1980] 1 All ER 814 (CA).

(126) In Morgan v Morgan & Porter (1869) 1 P & D 644 at 647.

to whom it is owed.[127] Clearly, the state of mind of the parties at the time of the disposition may well be relevant to the question of whether or not the disposition should be validated, but if the test is to be of practical value it is necessary to identify what states of mind will be relevant and what effect the presence or absence of a particular state of mind will have on the question of validation.

The concept of good faith requires a party by whom the good faith is owed and a party to whom it is owed. As Scott LJ said, in a different context, in Maclay v Dixon:[128]

> 'You cannot have good faith in the air: it is a moral conception, involving a moral duty of someone to someone.'

In Herrigel's case Lichtenburg J referred to good faith on the part of the 'parties concerned' and it would seem in context that he had in mind the disponor (the company) and the disponee. In other cases, too, the court appears to have had in mind good faith on the part of both parties[129] but in yet other cases the court appears to have had in mind good faith on the part of the company only[130] or of the disponee only.[131]

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(127) See Central Estates (Belgravia) Ltd v Woolgar [1971] 3 All ER 647 (CA) at 649 f-h for an examination of the difficulties in defining good faith, albeit in a different context.

(128) (1943) 170 LT 49 (CA) at 50, cited in Milne NO v Singh NO & Others 1960(3) SA 441 (D&CLD) at 456F-G.

(129) See, eg, In re Wiltshire Iron Company Ex p Pearson (1868) 3 Ch App 443 at 447; Re Steane's (Bournemouth) Ltd [1950] 1 All ER 21 (Ch) at 25A; *Re Omnico Ltd* (1976) 1 ACLR 381 (NSW) at 389-90.

(130) See eg In re International Life Assurance Society Gibbs and West's Case (1870) 10 Eq 312 at 323; Re Neath Harbour Smelting and Rolling Works (1887) 56 LT 727 (Ch).

(131) See eg In re Clifton Place Garage Ltd [1970] Ch 477(CA), although the disponee was also managing the company so the court may have had in mind good faith on the part of both parties.

There is, it is thought, no simple answer to the question of by whom the duty is owed because this question is inextricably linked to the question of the content of the duty, which is itself a complex question. These questions will therefore be dealt with together below in dealing separately with the position in regard to advance and ex post facto applications.

The question of to whom the duty is owed is, it is thought, simpler: the duty is owed to the general body of creditors.(132)

Good faith is a state of mind: bad faith cannot be *imputed* to a man because the law lays down certain requirements and he ought to have known them.(133) On the other hand, if one avoids becoming aware of information which would make one mala fide in relation to a transaction, such avoidance is itself bad faith.(134)

The *reference* to good faith is often coupled to a reference to the disposition's being in the ordinary course of business:(135)

> '... where a company actually trading, which it is the interest of every one to preserve, and ultimately to sell, as a going concern, is made the object of a winding-up Petition, which may fail or may succeed, if it were to be supposed that transactions in the ordinary course of its current trade, bonâ fide entered

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(132) Cf In re Dalton Ex p Herrington and Carmichael v The Trustee [1963] Ch 336 at 354 and Re Hasler; Official Receiver v Bank of New South Wales (1974) 23 FLR 139 (Fed Ct of Bkrcy) at 142 in which the good faith referred to in the sections of the English and Australian Bankruptcy Acts protecting payments in good faith to the bankrupt was held to be owed to the general body of creditors.

(133) See eg Milne NO v Singh NO & Others 1960 (3) SA 441 (D & CLD) at 456E-F; but see In re All India Home Relief Insurance Co *AIR 1939 Sind 196 at 199 referred to more fully at 544 n 174* below.

(134) R v Myers 1948 (1) SA 375(A) at 382-3.

(135) The ordinary course of business test is dealt with in the next section.

> into and completed, would be avoided, and would not, in the discretion given to the Court, be maintained, the result would be that the presentation of a Petition, groundless or well-founded, would, ipso facto, paralyse the trade of the company, and great injury, without any counterbalance of advantage, would be done to those interested in the assets of the company'

(per Lord Cairns in In re Wiltshire Iron Company Ex p Pearson[136]). Lord Cairns appears to have only had in mind contracts entered into and performed after presentation of the winding-up application, but his statement has been understood, mistakenly it is believed,[137] in some later cases to also refer to payments made to pre-presentation creditors:

> '...this was a transaction which is directly within the passage which I have read from the judgment of LORD CAIRNS in Re Wiltshire Iron Co. and I can myself see no ground for distinguishing between the amount of the debit existing immediately before the presentation of the petition, viz., £803,11s., and the amount by which the overdraft became increased after the presentation of the petition'

(per Wynn-Parry J in Re T W Construction Ltd[138]). After presentation the company had first increased its overdraft and had then repaid the bulk of the overdraft, including the portion that already existed on presentation.

Although the tests enunciated by Lord Cairns have often been understood as also aplying to the discharge of pre-presentation debts they have seldom been applied so as to validate the discharge of such a debt:[139]

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(136) (1868) 3 Ch App 443 at 447.

(137) See further 545-52 below but cf 554-60 below.

(138) [1954] 1 All ER 744 (Ch) at 748G-H.

(139) See 502-507 above.

> 'I do not mean to express any dissatisfaction with the cases *which have been cited by Mr. North,*[140] as deciding that all bonâ fide transactions in carrying on the ordinary business of a company, which take place between the petition and the winding-up order, and have been completed before the winding-up order is made, should be confirmed. But here the question is, whether the very creditor who has prosecuted *the petition should* be allowed to retain money which he has obtained by means of the petition, when the result of the petition is that the assets of the company are to be divided equally amongst its creditors.
>
> 'It appears to me that it would be contrary to sound principle, and to the principle which has always prevailed in bankruptcy, if that were to be allowed'

(per Mellish LJ in In re Liverpool Civil Service Association *Ex p* Greenwood[141]). Although Mellish LJ referred only to payments to the petitioning creditor the same is, it is thought, equally true of payments to any other *pre-presentation creditors.*[142]

It is also possible, if not probable, that the courts will avail themselves *of the good faith* test to decline to validate dispositions tainted with moral turpitude despite the fact that the moral turpitude would not ordinarily be sufficient to render the disposition void in law,[143] but it may be questioned whether the

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(140) The Wiltshire case and In re International Life Assurance Society Gibbs and West's Case (1870) 10 Eq 312.

(141) (1874) 9 Ch App 511 at 512.

(142) See eg Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor 1980(4) SA 669 (SWA) at 678G-H and 680C.

(143) See eg In re London, Hamburg and Continental Exchange Bank Emmerson's Case *(1866) 2 Eq 231 which related to a transfer of* shares in a company against which a winding-up petition had been presented. Like a disposition of the company's property, such a transfer is void under the English counterpart of s 341(1) unless the court otherwise orders, and in refusing to validate the transfer Lord Romilly MR said (at 236):

(Footnote continued on next page)

court's discretion should be used to enforce standards of conduct which the law does not itself seek to do.

(i) Advance applications

In advance applications for validation the question of the good faith or otherwise of the parties is, it is considered, largely irrelevant.

In an advance application the criterion for validation is whether or not the proposed disposition is in the interests of the shareholders or of the creditors depending upon whose interests the court considers to be paramount in accordance with the principles

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(Footnote continued from previous page)

'A company ... having shares in another company, and being aware that it was about to fail, transferred those shares in the failing company to A.B., and then applied to me in Chambers and asked for leave at once, before the list of contributories was made out, to put A.B. on the list of shareholders instead of the company which owned the shares; that company undertaking to enter into a guarantee that A.B. should pay all the calls upon them, and making themselves liable to that effect. The object, which is very obvious, was to conceal from their own customers the fact that they took shares in the company that failed. Now I have refused to do that. I am of opinion that that is a case in which the 153rd section applies; that as the tree falls so it must lie; and as the foundation of all equity is truth, if any persons come before me for the purpose of misleading any persons who have placed confidence in them on the supposition that they did not take shares in the company, because their names do not now appear in it, they must not appeal to me for that purpose. I shall refuse to make any transfer of that description.'

In other words, Lord Romilly MR refused validation not on the grounds of prejudice to the creditors of the company against which the winding-up petition had been presented - for whose protection the section was intended - but on the grounds that the shareholder concerned was acting reprehensibly towards its customers.

dealt with in the preceding section. If it is it will be validated, irrespective of whether or not the company and disponee are in good faith.

True, the belief of the directors as to whether or not the disposition is in the interests of the shareholders or creditors, as the case may be, is important evidence which the court will weigh in reaching its conclusion, but their belief remains purely evidential and is no part of the test itself.

The disponee's motives are, it is thought, entirely irrelevant. If, for example, the disponee is the only available supplier of goods essential for the company's business which it is in the interests of the shareholders and creditors to continue, and if the disponee is only prepared to supply further goods if the court validates payment not only of the price of the new goods but also of the disponee's pre-presentation claim, the court may have no alternative but to validate the payment despite the fact that the disponee's avowed object is to get a preferential payment.

(ii) Ex post facto applications

(A) Good faith on the part of the company

In ex post facto applications good faith on the part of the company is, it is thought, again irrelevant.(144) The view has already been taken(145) that in an ex post facto application 2

(144) In In re International Life Assurance Society Gibbs and West's Case (1870) 10 Eq 312 the court relied heavily on the directors' good faith in validating the disposition in question, but the view is taken at 541-3 below that the court had in mind their good faith in their personal capacities rather than their good faith in their capacity as directors.

(145) See 523-4 above.

questions arise: Would validation be in the interests of the creditors, and if not, do considerations of justice and fairness vis-à-vis the disponee dictate that the disposition should be validated? The first question is an objective one and the directors' good faith or otherwise at the time of effecting the disposition would seem irrelevant. Similarly, it is difficult to conceive of a situation in which the directors' subjective good faith could have a bearing on the second question either. For example, if the directors were to deliberately enter into a contract which is prejudicial to the company, the contract would in any event not fulfil the first criterion for validation mentioned above in that validation *would* not be in the interests of the creditors and the question would then be whether considerations of justice and fairness towards the disponee dictate that *the disposition should be validated, and it is* difficult to conceive of how the directors' bad faith could be relevant to this question.

(B) Good faith on the part of the disponee

The state of mind of the disponee, on the other hand, may well be relevant to the question of whether or not a disposition should be validated. Three relevant states of mind can, it is suggested, be distinguished.

(01) Knowledge that disposition was not in interests of creditors

If the disponee knew at the time the disposition occurred that it was not in the interests of the creditors, this may obviously be expected to weigh with the court. This is especially so where the disponee was also aware that the company was in financial difficulties, but it is thought that even where he was unaware of the company's financial position, or wrongly believed it to be sound, the fact that he knew the disposition was not in the

interests of creditors should weigh against him. Generally the fact that he knew that the disposition was not in the interests of creditors should have put him on his guard and often his conduct will amount to snatching at a bargain.

If the disponee did not in fact know that the disposition was not in the interests of creditors but ought to have known, this too will, it is thought, weigh against him. In Re Gray's Inn Construction Company Ltd[146] the court went much further by holding that a bank which permitted a company to continue to operate its account should have instituted safeguards to ensure inter alia that the company only continued to operate the account as long as it was in the interests of creditors that it did so. No such onus had been imposed on a bank or any other person in any previous case and the view will be taken below[147] that the imposition of such an onus leans too far in favour of the general body of creditors at the bank's expense and is in any event counter-productive because few banks can be expected to be willing to accept such an onus, with serious consequences if the company is still trading.

What is the position if the interests of the shareholders and not of the creditors would have been regarded as taking precedence had an advance application for validation been made? If the disponee was aware of this and relied on it, it would seem hard to deny him validation on the ground that he knew the disposition was not in the interests of the creditors, and it is doubted whether the courts would do so. If, however, he was unaware that the shareholders' interests would have taken precedence it is suggested that the fact that they would have done so will not avail him.

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(146) [1980] 1 All ER 814(CA).

(147) See 583-92 below.

If the disponee reasonably believed that the disposition would be in the interests of the creditors but it in fact turned out not to be so this should not, it is believed, count against him.

Where the disponee has no choice as to whether or not the disposition occurs, knowledge on his part at the time the disposition occurs that the disposition is not in the interests of creditors would not seem relevant. For example, if after presentation a company exercises an option granted to it prior to presentation, knowledge on the grantor's part at the time the option is exercised that the resulting contract is not in the interests of creditors would seem irrelevant to the question of whether or not the contract should be validated. If, however, the disponee knew at the time of granting the option that the contract that would result if the option were exercised would not be in the interests of creditors this will, it is suggested, weigh against him even if the option was granted prior to presentation. True, it can be argued with considerable cogency that regard should not be had to what occurred prior to presentation - eg other pre-presentation creditors' claims are not subject to any such scrutiny - but it is suggested that the courts may well be unwilling to disregard bad faith on the part of the disponee even if it preceded presentation, where the disposition requires validation and it can, and must, therefore be subjected to scrutiny.

A disposition may not be in the interests of creditors for a variety or reasons. For example, in the case of, say, a loan to the company, the terms of the loan may be unfavourable, or the company may not need a loan at all, or it may be intended to put the monies borrowed to an improper purpose.(145) In other words, a broad view

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(148) Cf Re Steane's (Bournemouth) Ltd [1950] 1 All ER 21(Ch) at 24H.

should, it is believed, be taken of the question of whether or not the disposition was in the interests of creditors and even if it was *only indirectly prejudicial* to them - as where the proceeds were intended to be put to an improper use - this should weigh against the disponee if he was aware of it.(149)

The application of these criteria is canvassed further below.(150)

(02) Knowledge of presentation of winding-up application/financial difficulties

In a number of validation applications the court has referred to the fact that the disponee either knew or did not know of the presentation of the winding-up application.(151)

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(149) This must not, however, be taken to extremes - see eg 575-6 below.

(150) Ibid.

(151) See eg The National Bank's Case (1873) 28 LT (Eur Arb) 92; In re All India Home Relief Insurance Co *AIR 1939 Sind 196 at* 199; Anhadra Bank Ltd v Narayana Rao AIR 1955 Madras 247 at 249-50; Re J Leslie Engineers Co Ltd [1976] 2 All ER 85 (Ch) at 95 f-g; Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor 1980 (4) SA 669 (SWA) at 680C-D; Re Gray's Inn Construction Co Ltd [1980] 1 All ER 814(CA) at 822j-823b and 820h-j. Cf, too, In re The Civil Service and General Store Ltd (1888) 57 LJ Ch 119 *at 120*; *In re Park Ward and Company* Ltd [1926] Ch 828 at 831-2; Re Steane's (Bournemouth) Ltd [1950] 1 All ER 21(Ch) at 24A; Re T W Construction Ltd [1954] 1 All ER 744(Ch) at 748E-F; Re Atlas Truck Service (Pty) Ltd (1974) 4 ACTR 19 at 21 (20-30); Re Selmar (Pty) Ltd [1978] VR 531 at 534(20-25); Tulsidas v Industrial Bank of Western India AIR 1931 Bombay 2 at 19; Re J Sen Gupta Private Ltd AIR 1962 Cal *405 at 408-9.*

In The National Bank's Case[152] payment had been made to a creditor after presentation and the liquidator sought to recover the payment in terms of the English counterpart of s 341(2). Lord Westbury, sitting as an arbitrator, said:[153]

> 'I am desired to recall money that was paid in discharge of a bonâ fide debt. Now when an appliation is made for that purpose, you must show that the creditor receiving the money knew, or ought to have known, at the time, that the person paying it had no right to make that payment ....
>
> '... if the ratio decidendi, if the point in the case be that, I must ascertainn that he had, or ought to have had, or might with reasonable diligence have had, a knowledge of the fact of the pendency of this petition, I should then probably be bound to say that it must be paid back, not perhaps irrevocably, but it must be paid back, and you must make the best of an application to court.'

On the other hand, in In re All India Home Relief Insurance Co[154] the court considered that:

> '... it is wholly immaterial whether the person making or receiving the payment had or did not have notice of the presentation of the petition for winding-up ...'

In Re J Leslie Engineers Co Ltd[155] the court took a view falling between these extremes:

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(152) Supra.

(153) At 94.

(154) Supra at 199. See also the Anhadra Bank case supra.

(155) Supra at 95f-g.

> 'Whilst obviously the absence of any actual knowledge in the recipient of a payment that a petition is in being is a factor - indeed a very powerful factor - to be considered in relation to the exercise of discretion, I do not think that, by itself, it can be conclusive....'

In the event, the court refused to validate the preferential payment of a pre-presentation creditor who was unaware of the presentation, saying:(156)

> '... the court must keep in view the evident purpose of the section which ... is to ensure that creditors are paid pari passu.'

Which approach is correct? The answer is, it is thought, that it is irrelevant whether the creditor was aware of the presentation of the winding-up application. The object of s 341(2) is to ensure as far as possible that concurrent creditors benefit pari passu and if effect is to be given to this object the fact that the disponee either knew or did not know of the presentation would seem irrelevant in all cases in which the preferential discharge of a creditor's claim is in issue. As Lichtenberg J said in Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor:(157)

> 'To validate such preferential payment simply because first defendant did not know that it was being preferred when the payment was made to it, would, in my judgment, defeat the whole purpose of s 341 of the Companies Act.'

Moreover, there would seem to be little reason why a creditor should be entitled to retain a preferential payment simply because he was unaware that a winding-up application had been presented.

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(156) At 95g.

(157) Supra at 680C-D.

This was, however, apparently not how the court saw the question in Re Gray's Inn Construction Co Ltd.[158] A company continued to operate its bank account, which was in overdraft, after presentation of a winding-up petition against it. Initially the bank was unaware of the presentation of the petition and on this ground the court validated all deposits to the account up to the date on which the bank became aware of the presentation of the petition. However, the facts of the case and the precise terms of the judgment are complex[159] and it is not clear that the court would have validated the deposits had the only relevant facts been that the deposits were made at a time when the bank was unaware of the presentation of the petition. In particular, withdrawals were also made from the account during the same period and it would clearly have been harsh on the bank if the deposits had not been validated with the result that it was left with a considerably increased unsecured claim. This reason is not mentioned in the judgment but, with respect, is the true basis for the validation of the deposits.[160]

The court also held that once the bank had become aware of the presentation it ought to have instituted safeguards to ensure that cheques were only drawn on the account in the ordinary course of the company's business, that no preferential payments were made to some creditors at the expense of others, and that the company only continued to trade as long as it did so at a profit. In other words, the court held that knowledge of the presentation imposed an onus on the bank to take positive steps to ensure that the continued operation of the bank account would be in the interests of creditors. However, this aspect of the judgment is also criticised

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(158) Supra.

(159) See 583-92 below.

(160) See 554-62 below.

below[161] on the grounds that it is unrealistic and leans too far towards protecting the creditors at the expense of the disponee. Clearly, if a disponee is aware that the disposition is not in the interests of creditors this should weigh against him, but to expect him to take positive steps to ensure that it is in the interests of creditors is to expect too much of him and few persons can be expected to accept such an onus with the result that the business of the company is in danger of being paralysed.

What has been said thus far relates to the discharge by a company of an obligation owed by it, but it is considered that the same is equally true where the disposition consists of the conclusion of a contract. The circumstances in which the conclusion of a contract should be validated are dealt with below[162] and the view taken there is that all normal, arm's length contracts should be validated unless the disponee knew or ought to have known at the time of the conclusion of the contract that the contract was not in the interests of the creditors, except that if the shareholders' interests would have taken precedence had an advance application been made and the disponee knew this and relied on it, validation should be granted even if he knew that the contract was not in the interests of the creditors. On this approach, therefore, it is not knowledge of the presentation but knowledge that the contract is not in the interests of creditors that is relevant.

The Gray's Inn case was not concerned with the conclusion of contracts because the conclusion of a contract is not a disposition within the meaning of the English counterpart of s 341(2), but it may be surmised that had the court been concerned with this question it would not have agreed with the above approach and would have held

(161) See 583-92 below.

(162) See 555-7 below.

that failure by the bank to institute the safeguards referred to above would also have rendered the bank liable to a refusal to validate the contracts involved in the continuation of the bank account.

Should it be held that the above views are incorrect and that knowledge of the presentation of the winding-up application on the part of the disponee is a material factor in a validation application, it is suggested that knowledge that the company is in financial difficulties should have a similar significance.(163)

On the other hand, the fact that the disponee was aware that a winding-up application had been presented is not a bar to validation.(164)

It seems that a bank will be regarded as being aware of the presentation of a winding-up application as soon as notice is received by its head office even if there is a delay in the notice coming to the attention of the branch where the company has its account.(165)

(03) Motive to benefit creditors or the company

If the disponee's motive in entering into or performing a contract is to benefit the creditors or the company and not the

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(163) Cf In re The Civil Service and General Store Ltd (1888) 57 LJ Ch 119 at 120; Re Selmar (Pty) Ltd [1978] VR 531 at 532(30-50); Albion Reid (SA) (Pty) Ltd v Baron Holdings (Pty) Ltd (1973) 7 SASR 564 at 567.

(164) See eg Re Gray's Inn Construction Co Ltd [1980] 1 All ER 814(CA); In re Clifton Place Garage Ltd [1970] Ch 477 (CA); In re Park Ward and Company Ltd [1926] Ch 828; Re Atlas Truck Service (Pty) Ltd (1974) 4 ACTR 19 at 21.

(165) Re Gray's Inn Construction Co Ltd [1980] 1 All ER 814(CA) at 817e and 823a.

pursuit of personal gain, this may well weigh with the court in an ex post facto application for validation of the contract or the performance by the company of its obligations under the contract, especially if the disponee ran the risk of personal loss.(166) For example, if a director of a company were to lend money to the company after presentation of a winding-up application against it because he believed that the loan might enable the company to trade out of its difficulties and that at worst it would enable the business to be continued and in due course to be sold as a going concern to the benefit of all concerned, the court would, it is believed, be likely to validate both the contract of loan and such repayments as might have been made on account of the loan.

This is, it is believed, the true basis for the decision in In re International Life Assurance Society Gibbs and West's Case.(167) The company had run into financial difficulties and the directors(168) were negotiating the sale of its business on terms which would have resulted in its creditors being paid in full. While the negotiations were proceeding the company's bankers pressed for repayment of the company's overdraft and as the bankers were in a position to embarrass the company the directors negotiated an extension of time by causing the company to give security for the overdraft and by giving their personal guarantees. This occurred after a petition for the winding-up of the company had been presented. In the event the negotiations for the sale of the business fell through and the company was placed in winding-up. Two

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(166) Cf Tulsidas v Industrial Bank of Western India AIR 1931 Bombay 2 at 23.

(167) (1870) 10 Eq 312.

(168) It may be noted that the directors were also shareholders and were therefore not entirely disinterested parties, but although they were no doubt conscious of the coincidence between their personal interests and the course of action they took this does not appear to have been their principal motivation.

of the directors discharged the bankers' claim pursuant to their personal guarantees and were therefore subrogated to the bankers' rights to the security.

The court validated the security, holding that the transaction was bona fide and in the ordinary course of business within Lord Cairns' classic dictum quoted above;[169] however, as already pointed out, Lord Cairns' statement was, with respect, never intended to apply to the discharge of pre-presentation debts. The true basis for the decision is, it is suggested, that the directors ran the risk of personal loss in the reasonable belief that their actions would benefit the company and its creditors, and they would have been the ones to suffer had validation been refused.[170]

This is also, it is thought, the basis for the decision in Re Steanes (Bournemouth) Ltd.[171] The company became pressed for funds and a director[172] agreed to lend the company £5 000 on the

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(169) See 528-9 above.

(170) Cf, however, In re John Daly & Co Ltd (1886) 19 LR (Ireland) 83 in which the auditor of the company was prevailed upon to make a loan to the company to enable it to carry on business in anticipation of the directors' resolving to issue further debentures to raise the necessary additional capital. The directors refused to do so and the company was placed in winding-up. After presentation the loan was repaid. The auditor was at all times aware of the company's embarrassed position. The court refused to validate the repayment despite the fact that he apparently only made the loan to assist the company, although the court may have been influenced firstly by the fact that it was agreed at the time the loan was made that in the event of the company's being placed in winding-up he would receive the preferential discharge of his claim and secondly by the fact that he was apparently privy to the falsification of the company's records to show that the repayment of the loan had occurred prior to presentation.

(171) [1950] 1 All ER 21 (Ch).

(172) As in the International Life case, he, too, was a shareholder.

security of a debenture. Because of the urgency, portion of the £5 000 was advanced before the debenture had been issued. The director's motive was at all times to act in the interests of the company. A petition for the winding-up of the company was presented between the advance of the first portion of the loan and the issue of the debenture. The court validated the debenture in relation to the full amount advanced, including the portion advanced prior to presentation.

Is it necessary that the contract should in fact benefit the creditors? The answer is, it is suggested, that it is not necessary:

> 'Some emphasis was placed in argument on the fact that what happened did not, in the event, save the company from being wound up. Nothing succeeds like success, and by definition the cases in which the company is saved from being wound up will never reach the Court. It is often easy to be wise after the event, and to suggest alternative courses of action which might have been preferable had they occurred to anyone at the time, or which may have a superficial appearance of reasonableness or practicality when far removed from the heat of events'

(per Wootten J in Re Omnico Ltd[173]).

A further question to arise is whether the belief that the contract would be in the interests of the creditors or company must be reasonable. This question was pertinently considered by the court a quo in In re Clifton Place Garage Ltd[174] and the court held

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(173) (1976) 1 ACLR 381 (NSW) at 390(20-30). See also, eg, In re Clifton Place Garage Ltd [1970] Ch 477 (CA); Re Steane's (Bournemouth) Ltd [1950] 1 All ER 21(Ch); In re International Life Assurance Society Gibbs and West's Case (1870) 3 Eq 312.

(174) [1970] Ch 477 (CA) at 484-5. Cf too In re All India Home Relief Insurance Co *AIR 1939 Sind 196* at 199 in which the court referred to 'the rule that nothing can be said to be done in good faith which is done without due care and attention.'

that the belief must be reasonable. (On appeal the Court of Appeal reversed the court a quo's finding that the disponee had not acted reasonably, and it therefore did not find it necessary to comment on the court a quo's view that the disponee's belief must be reasonable.) The better view is, it is suggested, that the court will still attach some weight to the disponee's motives even if they were unreasonable, but that the weight that will be attached will be less.

(d) Ordinary course of business - avoidance of paralysis of the company's business

A factor referred to in many cases[175] is that the disposition was in the ordinary course of the company's business. This criterion had its origin in Lord Cairns' judgment in In re Wiltshire Iron Company Ex p Pearson:[176]

> '... where a company actually trading, which it is the interest of every one to preserve, and ultimately to sell, as a going concern, is made the object of a winding-up Petition, which may fail or may succeed, if it were to be supposed that transactions in the ordinary course of its current trade, bonâ fide entered into and completed, would be avoided, and would not, in the discretion given to the Court, be maintained, the result would be that the presentation of a Petition, groundless or well-founded, would, ipso facto, paralyze the trade of the company, and great injury, without any counterbalance of

(175) See eg In re Wiltshire Iron Company Ex p Pearson (1868) 3 Ch App 443 at 447; In re Liverpool Civil Service Association Ex p Greenwood (1874) 9 Ch App 511 at 512; Re Llangennech Coal Company (1887) 56 LT 475 at 477; Re Neath Harbour Smelting and Rolling Works (1887) 56 LT 727(Ch) at 729; Re Gray's Inn Construction Co Ltd [1980] 1 All ER 814(CA) at 820h and 822g; Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor 1980 (4) SA 669 (SWA) at 679C; Re Norman King and Co (Pty) Ltd (1960) 60 SR (NSW) 98 at 104; Re Omnico Ltd (1976) 1 ACLR 381 (NSW) at 389(50)-390(10); Tulsidas v Industrial Bank of Western India AIR 1931 Bombay 2 at 15; Anhadra Bank Ltd v Narayana Rao AIR 1955 Madras 247 at 249.

(176) (1868) 3 Ch App 443 at 447.

advantage, would be done to those interested in the assets of the company.'

In the Wiltshire case the entire transaction - the sale and the delivery - took place after presentation of the winding-up petition, and it is thought that Lord Cairns' statement was only intended to refer to such a situation and not also to the discharge of pre-presentation debts. However, as pointed out above,(177) it has been understood in some subsequent cases as also applying to the discharge of pre-presentation debts.

Lord Cairns' concern was that if the courts were not to validate dispositions in the ordinary course of business the mere presentation of a winding-up petition, whether well-founded or not, would paralyse the company's business because other persons would be unwilling to do business with the company. In England, it will be recalled,(178) this is a particularly serious risk because the fact that a winding-up petition has been presented is immediately advertised in the official gazette. Nevertheless, even in this country the fact that a winding-up application has been presented seldom in practice remains entirely confidential(179) and Lord Cairns' concern therefore has a relevance in the South African context too. In fact, in one respect it is even more relevant in the South African context: in this country, it will be recalled,(180) it is not only the transfer of ownership and other real rights that constitutes a disposition but also the conclusion of a contract for such a transfer. Needless to say, these differences must be borne in

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(177) See 528-9 above

(178) See 249 above. The same is true of Australia and India - see 253 above.

(179) eg the application may be served by attaching it to the front door of the company's business premises where it may be seen by employees and customers.

(180) See 325-38 above.

mind in seeking to apply the criteria enunciated by Lord Cairns to s 341(2).

In Tulsidas v Industrial Bank of Western India[181] the Bombay Court of Appeal drew a distinction between the ordinary course of business before and after presentation:

> 'There is, I think, a dividing line between what is in the ordinary course of business before a winding-up petition is presented and what is in the ordinary course afterwards. Before a petition is presented it is in the ordinary course of business for a company to pay all its debts .... But after a petition is presented the situation is different. Prima facie all debts will have to be paid pari passu. Therefore it is no longer in the ordinary course of business to pay one creditor in full to the detriment of his fellow creditors.'

However, whether Lord Cairns would have intended such a distinction to be drawn for the purposes of the criteria enunciated by him is unclear.

Despite the emphasis placed on the ordinary course of business test in many of the cases, it is not an invariable requirement for validation:

> 'Although Lord Cairns referred to transactions in the ordinary course of current trade, this has not come to be regarded as a pre-requisite for an order under s. 227'

(per Wootten J in Re Omnico Ltd[182]).

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(181) AIR 1931 Bombay 2 at 15.

(182) (1976) 1 ACLR 381 (NSW) at 390(5-10). See too Re J Sen Gupta Private Ltd AIR 1962 Cal 405 at 409. In Re Atlas Truck Service (Pty) Ltd (1974) 4 ACTR 19 at 22(10-15) the court appears at first sight to have gone further:

(Footnote continued on next page)

Again, it is convenient to distinguish between advance and ex post facto applications in seeking to determine the validity and area of application of the ordinary course of business test.

(i) Advance applications

In the case of an advance application for the validation of a disposition, the issue is whether or not the disposition is in the interests of the interested parties. If it is, the court will validate it irrespective of whether or not it is in the ordinary course of business. Where, however, the interests of the creditors and shareholders are in conflict and there is no clear indication as to whether the winding-up application will succeed or fail, it is thought that the ordinary course of business test will play an important role and that the courts will tend to validate dispositions necessary for the continued conduct of the company's business in the ordinary course while there is a possibility of the winding-up application's not succeeding so as to avoid the paralysis of the company's business, despite the fact that the creditors may suffer some prejudice if the winding-up application does succeed.(183) It is suggested, however, that the appropriate test is that the disposition is necessary for the continuation of the company's business, not simply that it takes place in the course of the continuation of the business.

(Footnote continued from previous page)

'Although the phrase "ordinary course of business" is referred to as a test in one or two of the text books (see, for example, Palmer's Company Law, 21st ed, p. 770; Gore-Browne on Companies, 42nd ed. p. 956) it is not part of any test which has been applied by the courts.'

It is thought, however, that Fox J meant no more by this statement than that it is not necessarily essential in every case that the disposition should have been in the ordinary course of business to qualify for validation.

(183) See further 517-23 above.

(ii) Ex post facto applications

In the case of ex post facto applications the position is more complex and calls for the consideration of a number of questions.

(A) Object of test is avoidance of paralysis of company's business

As already stated, the object of the ordinary course of business test is the avoidance of the paralysis of the company's business. Of course, by the time an ex post facto application for validation is made the question of the paralysis of the company's business has ceased to be relevant insofar as the company itself is concerned because paralysis will either have been avoided or not, and the real question before the court is whether, as a matter of general policy, the court should validate dispositions made in the ordinary course of the company's business with a view to giving other persons dealing with other companies in the future confidence that dispositions in the ordinary course of a company's business will be validated, so as to avoid the paralysis of such other companies' businesses.(184)

The question may be asked, however, whether the desirability of such a general policy is a proper consideration in an application for validation of a disposition by a company which no longer stands

(184) It was clearly Lord Cairns' intention to lay down such a general policy because the Wiltshire case was itself an ex post facto application. In fact, the disponee was not even aware of the presentation of the winding-up petition so that there was at no time any danger that the disponee would have refused to have dealings with the company. The court nevertheless validated the disposition to him on the grounds that such a general policy is necessary to avoid the paralysis of a company's business, despite the fact that the policy never had any application to him and no longer had any application to the company.

to benefit by the policy. Could it not be argued, for example, that the better approach is that if a company is faced with the prospect of the paralysis of its business, it should apply in advance for the validation of the contracts it will need to enter into, and of the discharge of the obligations it will need to discharge, in order to continue its business, and that if it manages to get by without making such an application the avoidance of the paralysis of the company's business will be irrelevant in an ex post facto application?

The disadvantage of requiring that application be made in advance for validation is, it is thought, that it would inevitably lead to a proliferation of applications for validation. The legal costs incurred in making the applications would not only further embarrass the company, but would in addition reduce the assets of the company ultimately available for distribution if a winding-up order is granted. The company might also have difficulty procuring legal services to make the necessary application or applications for validation because both the contract and the payment for the services would themselves be dispositions subject to validation. But, perhaps most serious of all, an advance application for validation would publicise the otherwise confidential, or at least largely confidential, fact that a winding-up application had been presented against the company with the result that, even armed with a validation order, the company would be likely to find that many if not most of its sources of credit had dried up.

What, then, is the answer to the question posed above as to whether the desirability of a general policy of avoiding the paralysis of the businesses of companies against which winding-up applications have been presented is a proper consideration in an application for validation of a disposition by a company which no longer stands to benefit by the policy? The answer is, it is suggested, that it is fortunately not necessary to seek the answer

to this conundrum because the paralysis of a company's business is in any event avoided for other reasons.

Justice and fairness towards the disponee is clearly an important factor in an ex post facto application for validation - see the next section[185] - and if the question is approached from this point of view it becomes clear, it is thought, that the paralysis of the businesses of companies against which winding-up applications have been presented is avoided, not because this is necessarily an end in itself but because a person proposing to have dealings with such a company has no cause to refuse to have such dealings for fear of non-validation if he knows that justice and fairness towards him will be the criterion if he has to seek validation subsequently.[186]

This may be put another way. The interrelationship between justice and fairness towards the disponee on the one hand and the avoidance of the paralysis of the company's business on the other is very close. If the object of avoiding the paralysis of the company's business is to be achieved it is essential that persons dealing with the company should be assured that the courts will be just and fair towards them if they are later compelled to seek validation of the dealings; conversely, if the criteria for validation are just and fair towards the disponee this should achieve as far as possible the object of avoiding the paralysis of the company's business.[187]

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(185) See 554-62 below.

(186) This is considered in detail at 554-62 below.

(187) The object of justice and fairness to the disponee goes further than the object of the avoidance of the paralysis of the company's business in that it applies whether or not the disponee was aware of the presentation, whereas the avoidance of the paralysis of the company's business only arises if the disponee was aware of the presentation because it is only if the disponee was so aware that there was a danger of his refusing to deal with the company on this ground.

(B) The test is unlikely to achieve the object of avoidance of paralysis of the company's business

With respect, the test as formulated by Lord Cairns is in any event unlikely to achieve the object of the avoidance of the paralysis of the company's business.

The first point to be noted is that Lord Cairns refers to the ordinary course of the company's business;[188] accordingly, it would seem that it is not sufficient that the disposition is in the ordinary course of business ie is normal and arm's length.[189] Secondly, Lord Cairns refers to the test in the context of a co[illegible]y which is carrying on a business that it is in everyone's interest to preserve as a going concern. In other words, a person proposing to enter into a transaction with a company against which a winding-up application has been presented would apparently need to ensure

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(188) In a number of later cases reference is made simply to 'the ordinary course of business', but it is thought that even in these cases what was meant was the ordinary course of the company's business - see eg Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor 1980(4) SA 669 (SWA) at 679C; Re Neath Harbour Smelting and Rolling Works (1887) 56 LT 727 (Ch) at 729; Re Gray's Inn Construction Co Ltd [1980] 1 All ER 814 (CA) at 820h and 822g; Re Norman King and Co (Pty) Ltd (1960) 60 SR (NSW) 98 at 104.

(189) See eg Amhadra Bank Ltd v Narayana Rao AIR 1955 Madras 247. After presentation the company borrowed money from a bank and gave security for the loan. The bank was unaware of the presentation. The court refused to validate the security on the ground that the company was aware at the time that there was no possibility of its continuing to carry on its current business in the ordinary course and that there was therefore no question of the company borrowing monies in the ordinary course of its business within the scope of the criteria laid down in the Wiltshire case.

firstly that the transaction is in the ordinary course of the company's business and secondly that it is in the interests of *everyone to preserve the* business as a going concern[190] - a heavy onus indeed and one which few persons may be expected to be willing to accept.[191]

Could the test be reformulated to achieve the object of the avoidance of the paralysis of the company's *business eg by* reformulating it so as to refer to the ordinary course of business as opposed to the ordinary course of the company's business and so as to omit the requirement that it be in everyone's interest to preserve the company's business as a going concern? On this approach any transaction entered into and completed' by the company in good faith and in the ordinary course of business after presentation would be validated whether or not *the transaction was in the ordinary* course of the company's business and whether or not it was in

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(190) At first sight it may appear that Lord Cairns had *in mind* only disponees who are aware of the presentation because only such disponees would be likely to refuse to have dealings with the company on the grounds of the presentation, but in fact the disponee in that case was unaware of the presentation and Lord Cairns therefore must presumably have intended the criteria to also apply to disponees who are unaware of the presentation *even though their lack of knowledge prevents* them taking any steps to ensure that the disposition complies with the criteria laid down. This was how the criteria were understood in the Anhadra case supra.

(191) For example, most banks in England and Australia refuse to accept the onus - see eg in re Clifton Place Garage Ltd [1970] Ch 477(CA) *at 494B*; *Re Mal Bower's Macquarie Electrical Centre (Pty) Ltd* (1974) 1 NSWLR 254 at 257E. An exception was the bank involved in Re Gray's Inn Construction Co Ltd [1980] 1 All ER 814 (CA) but the bank concerned has since joined the other banks in refusing to accept the additional onus imposed by the court on the bank in that case - see further 239 above and 583-92 below.

everyone's interest to preserve the company's business as a going concern.

It is true that the effect of reformulating the test as suggested would in most, if not all, cases serve to achieve the object of avoiding as far as possible the paralysis of the company's business. However, there are also other objections to the test. As already pointed out,[192] the effect of the test is that the discharge of a post-presentation debt qualifies for validation despite the fact that the result is that some post-presentation creditors are preferred over others. Moreover, the test may result in the validation of dispositions where validation is not necessary for the avoidance of the paralysis of the company's business. Both objections may be illustrated by the case of 2 suppliers who after presentation supply the company with the identical goods on credit on identical terms, but only one of whom is paid. It may well be unnecessary to validate the discharge of the one supplier's claim to achieve the object of the avoidance of the paralysis of a company's business, and it may also well be unfair to the other supplier to do so.

(e) Justice and fairness towards the disponee

In Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor[193] Lichtenberg J said:

> '... each case must be dealt with ... according to the judge's opinion of what would be just and fair .... the Court, in assessing what is just and fair, must, inter alia, of necessity

(192) See 507-14 above.

(193) 1980 (4) SA 669 (SWA) at 678E and 678H-679A.

> strike some balance upon looking at what is fair vis-à-vis the applicant [the disponee] as well as what is fair vis-à-vis the creditors ...'(194)

In what circumstances will justice and fairness towards the disponee require that a disposition should be validated? In seeking the answer to this question it is convenient to distinguish 3 categories of disposition: the conclusion of a contract, the discharge of an obligation and a series of transactions.

(i) The conclusion of a contract

Where the disposition consists of the conclusion of a contract it is suggested that justice and fairness towards the disponee require that any normal, arm's length contract *should be validated*, unless the disponee was not in good faith.(195)

In such a case there is no question of the disponee receiving a preference: he gives value equivalent to the value he receives. It is obviously different where the contract is not normal or arm's length eg where a company sells goods at less than their real value.(196)

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(194) See too Re Steane's (Bournemouth) Ltd [1950] 1 All ER 21 (Ch) at 25A-B; In re Clifton Place Garage Ltd 1970 Ch 477 (CA) at 492A-C; Re Selmar (Pty) Ltd [1978] VR 531 at 534 (10-20); Re Omnico Ltd (1976) 1 ACLR 381 (NSW) at 389 (40-45); Commercial Grain Producers Association v Tobacco Sales Ltd 1983(1) SA 826 (ZS) at 830H.

(195) An alternative approach would be for the court to validate the contract to the extent of the other contracting party's negative interest, *ie his costs and expenses and the profit* he could have made elsewhere had he not entered into the contract, but the complexity of this approach detracts from any possible attractiveness it may have.

(196) The requirement that the contract be normal and arm's length is not strictly a separate requirement but an aspect of the requirement of good faith: if the contract was not normal and arm's length it can be inferred that *the disponee either must* have known or should have known that it might not be in the interests of creditors - see further 533-6 above.

It is true that the contract may not have been in the interests of the company or its creditors and if the other party knew this, validation would properly be refused on the grounds of the party's lack of good faith.(197) But if the other party was unaware that the contract was not in the interests of the company or its creditors should validation still be refused? The answer is, it is thought, in the negative. The validity of pre-presentation creditors' claims is not subject to any such condition, and it is thought that in doing justice as between the pre- and post-presentation creditors, there is no reason why post-presentation creditors' claims should be subject to such a condition either.

It is not possible to draw direct assistance from the English, Australian and Indian cases in regard to the appropriate criteria for the validation of the conclusion of a contract because the conclusion of a contract is not a disposition within the meaning of their counterparts of s 341(2). It is true that in the Wiltshire case Lord Cairns referred to transactions 'entered into and completed' after presentation but he was nevertheless only concerned with the question of whether or not the discharge by the company of its obligations under the transaction should be validated and it is doubted whether any inference can be drawn from the judgment as to whether he would have laid down the same criteria for the validation

(197) Unless the shareholders' interests would have taken precedence had an advance application been made and the disponee knew this and relied on it: see 534 above. If the disponee ought to have known that the contract was not in the interests of creditors the court may similarly be expected to refuse to protect him from his own negligence: ibid.

of the conclusion of the contract had this been in issue. In any event the criteria laid down by him have been criticised above.(198)

What is the position if the disponee has no choice as to whether or not the disposition occurs eg if after presentation a company exercises an option granted to it prior to presentation? The validity of claims of other pre-presentation creditors is not conditional upon the contracts out of which they arise having been normal and arm's length, and it can, it is thought, be argued with considerable cogency that the claim arising from the pre-presentation grant of an option should likewise not be subject to such a condition. However, it is doubted whether the courts will adopt this approach. Unlike the claims of other pre-presentation creditors, the claim arising out of an option granted before, but exercised after, presentation requires validation, and it is thought that the courts are unlikely to grant validation of an abnormal or non-arm's length contract even if the option was granted prior to presentation.

(ii) The discharge of an obligation

Where the disposition consists of the discharge by the company of an obligation owed by it, justice and fairness towards the disponee require, it is suggested, that validation should be granted to the extent, if any, the discharge was relied on by the disponee in discharging an obligation owed by him to the company, or in undertaking and discharging such an obligation, unless the disponee

(198) See 545-54 above.

was not in good faith.[199] This would apply equally to the discharge of pre- and post-presentation debts.

If, for example, as at presentation a company had utilised its full overdraft facility of, say, R1 000 and after presentation a deposit of R200 were to be made to the account and were thereafter to be withdrawn again, justice and fairness towards the bank clearly, it is thought, require that the deposit should be validated, and the reason for this is, it is considered, the bank's reliance on the deposit in allowing the withdrawal. Similarly, if only R150 were withdrawn again, the deposit would only be validated to the extent of the R150 because it would only have been relied on by the bank to this extent.[200] Other examples of dispositions that would be validated would be the supply of goods to the company against payment in cash, the advance of monies to the company against security furnished by the company, the supply of further goods to the company against payment for earlier supplies, etc.

This, it is believed, is essentially what Sachs LJ had in mind in In re Clifton Place Garage Ltd[201] in saying:

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(199) Unless the shareholders' interests would have taken precedence had an advance application been made and the disponee knew this and relied on it: see 534 above. If the disponee ought to have known that the discharge by the company of the obligation was not in the interests of creditors the court may similarly be expected to refuse to protect him from his own negligence: *Ibid.*

(200) Assuming that the view expressed at 490-2 above is correct that a disposition may be validated in part. If the overdraft facility were R1 250 the deposit would not be validated at all under this criterion because the deposit would not have been relied on by the bank in permitting the withdrawal, but the view will be taken at 560-1 below that it may qualify for validation for other reasons.

(201) [1970] Ch 477(CA) at 492E. See further 597-600 below.

> 'If the court acceded to the liquidator's contentions, the creditors would have the benefit of the major part of the £4,024 whilst in justice it should in the first place be allocated to reimburse so much as possible of the advances of £4,878 mentioned by Harman L.J. - those being advances which would never have been obtained without it being assumed that the £4,024 would be available as a counterbalance.'

(The underlining has been added) On presentation of a winding-up petition against the company its bank froze its account and its parent company thereupon in effect stepped into the bank's shoes paying debts due by the company and in turn receiving the company's daily takings. The amounts advanced by the parent company totalled £4878 and the takings received by it totalled £4024. No doubt had the daily takings not been received by it, it would not have made the advances. In other words, the parent company relied on the takings in making advances and was therefore entitled to validation in accordance with the criterion proposed above.

On the other hand, the suggested criterion is irreconcilable with cases such as *In re* Wiltshire Iron Company Ex p Pearson.(202) In that case, as already pointed out,(203) the company entered into a contract of sale after presentation, received payment in advance for the goods sold and thereafter delivered the goods to the purchaser. It follows that it is not possible to say that the purchaser relied on the delivery of the goods - it had not yet taken place - in paying the purchase price: he simply extended credit to the company for the delivery of the goods and in due course received delivery. The court nevertheless validated the delivery. The difference in approach between the suggested criterion and the Wiltshire case lies essentially in the fact that the Wiltshire case

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(202) (1868) 3 Ch App 443.

(203) See 507-14 above.

by implication held that the policy of pari passu distribution does not apply to post-presentation debts, a conclusion which has already been criticised[204] as there would not seem to be any warrant for the validation of the preferential payment of some post-presentation creditors' claims at the expense of the other creditors simply because the contract was in the ordinary course of the company's business and in the interests of the creditors. The contracts entered into by the other post-presentation creditors who have not been paid will generally also have been entered into in the ordinary course of business; accordingly, those creditors who have been paid were simply fortunate and this would not seem adequate reason for validating the preferential payments received by them. In extending credit to the company they ran the same risk as the other creditors and should rank pari passu with them.

(iii) A series of transactions

Although the criteria suggested in the preceding 2 sections should, it is considered, ensure justice and fairness towards the disponee in the case of isolated dispositions it is thought that they would not always go far enough towards affording the disponee the protection that justice and fairness demand in cases where there have been a series of post-presentation transactions. For example, if the company's overdraft stood at R2 000 on presentation although its overdraft facility was R10 000, and thereafter deposits and withdrawals each totalling R8 000 were made to the account with the result that the overdraft still stood at R2 000 at the grant of the order, the bank would probably not have relied on any of the deposits in permitting the withdrawals and would therefore not qualify for validation in accordance with the above criteria. This would, it is thought, not be just and fair towards the bank.

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(204) Ibid.

What would be just and fair in these circumstances? One approach would be to validate all the deposits, subject to the proviso that where the balance owing at the grant of the order is in fact less than the balance owing at presentation the deposits would not be validated to this extent. It is doubted, however, whether this would operate fairly in all cases. If, for example, the overdraft in the above example had first risen to, say, R4 500 and had thereafter been reduced again to R2 000, validation of the reduction again from R4 500 to R2 000 would prefer the bank over other post-presentation creditors and over the pre-presentation creditors. It follows, it is thought, that the fairest solution would be for the court to validate R5 500 of the deposits leaving the bank with a claim of R4 500 being the highest level to which the overdraft in fact rose after presention.

(iv) Conclusion

These criteria for validation are not formulated in this way in any of the cases on s 341(2) and its counterparts elsewhere, but it is suggested, with respect, that they would give rise to more satisfactory results than the criteria enunciated in the cases. True, the suggested criteria would sometimes result in the validation of dispositions which are not in the interests of the creditors - this is inevitable unless the creditors' interests always take precedence - but this would only be so where the other party is in good faith and where justice and fairness dictate that in balancing the interests of the creditors and the other party the other party's interests should take precedence.

Moreover, the proposed criteria have, it is believed, the important indirect effect of avoiding as far as possible the danger of the mere presentation of a winding-up application causing harm to the company's business. True, no-one who is aware of the

presentation is likely to extend new credit to the company (except against the furnishing of security) but the harm that this will cause the company is inevitable and will occur whatever criteria for validation are adopted by the courts. The proposed criteria will, however, minimise the harm by assuring protection to persons who:

- extend new credit to the company against the payment of old credit;

- extend new credit to the company against the furnishing of security by the company;

- supply goods and services to the company against payment in cash.

(f) Compassion for the disponee

In Re Selmar (Pty) Ltd[205] the court validated a disposition on the ground that not to have done so would have been unduly harsh on the disponee. After presentation of a petition for its winding-up, the company sold a property. The purchasers, unaware of the petition, paid a deposit, took occupation and made extensive improvements to the property. The price paid was fair. Starke J validated the sale saying:[206]

> 'It would seem to me harsh and inequitable if, without fault or knowledge on their [the purchasers'] part, they were deprived of such interest by the operation of an Act which they had no reason to suppose had any application to the transaction.'

It is doubted, however, whether the mere fact that the avoidance of a disposition in accordance with s 341(2) is harsh on the disponee is sufficient reason for the validation of the disposition. Windings-up are harsh - this is the risk one runs in dealing with a

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(205) [1978] VR 531.

(206) At 533(40-45).

company - and the general scheme of the Act is to treat creditors in a winding-up equally, irrespective of the degrees of hardship they are suffering.[207] Moreover, to alleviate one creditor's position necessarily entails increasing the prejudice suffered by the other creditors.

(g) Assimilation to the insolvency law position

In Re Répertoire Opera Co[208] Vaughn Williams J said:

> 'If the transaction is one which would be valid under the protective sections of the Bankruptcy Act, that would be a very strong reason for my validating it here .... The cases on section 153 ... are an adoption by the Court of the principle of the protective sections in bankruptcy. It would be very unfortunate if the principles of administration in bankruptcy and in the winding up of companies were not as far as possible the same.'

In Re T W Construction Ltd[209] the court agreed with the first sentence but not the second and third sentences, pointing out that the English counterpart of s 341(2) confers a discretion on the court which is absent from the Bankruptcy Act provisions and therefore the 2 situations are not comparable.

It is considered that the conclusion reached in the T W Construction case is equally applicable to s 341(2). It may well be that clearly defined impeachment rules such as those contained in the Insolvency Act are preferable to a broad discretionary provision such as s 341(2) - this is in fact the view taken below[210] - but

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(207) Cf Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor 1980(4) SA 669 (SWA) at 679A-F.

(208) (1895) 2 Mans 314 at 316 quoted in Re T W Construction Ltd [1964] 1 All ER 744 (Ch) at 746F. See too The National Bank's Case (1873) 28 LT (Eur Arb) 92 at 94.

(209) Supra at 746G.

(210) See 673-6 below.

the *Companies* Act clearly distinguishes between the Insolvency Act impeachment provisions, which it applies in the period up to presentation,[211] and s 341(2), which applies *thereafter*. It seems clear therefore that the legislature did not simply intend the courts to apply the Insolvency Act impeachment provisions in the exercise of their discretion under s 341(2). Of course there can be no objection to the courts' having regard to the Insolvency Act impeachment provisions as a guide to the exercise of their discretion; but it is suggested that caution is called for in doing so. The extent to which pre-insolvency transactions should be impeachable is a vexed question which has given rise to materially *different answers* in different countries[212] and it would be wrong to assume that the answers opted for in our Insolvency Act are necessarily more just in all cases than those opted for elsewhere.[213]

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(211) Section 340.

(212) See 647ff below.

(213) See too Re J Leslie Engineers Co Ltd [1976] 2 All ER 85 (Ch) at 93c-f and 95e; Re Atlas Truck Service (Pty) Ltd (1974) 4 ACTR 19 at 22(35-40); Re Omnico Ltd [1976] 1 ACLR 381 (NSW) at 388(30)-389(10); In re All India Home Relief Insurance Co AIR 1939 Sind 196 at 199. In Australia it has been held - see the *Omnico* case - that if a disposition is void both in terms of the Australian counterpart of s 341(2) and in terms of the provisions of the Bankruptcy Act as applied to windings-up, validation under the Australian counterpart of s 341(2) will not save the disposition from being void under the Bankruptcy Act. In this country, however, this *cannot arise* because the Insolvency Act provisions as applied to windings-up only apply to *dispositions* made prior to presentation - see s 340 - and s 341(2) only applies to dispositions thereafter. It would, however, arise, at least in theory, where a disposition could be set aside either at common law - see eg Voet 42.8; Fenhalls v Ebrahim & Others 1956(4) SA 7%3(D&CLD); Mars Insolvency ¶ 12.19 - or under s 341(2), although it is difficult to conceive of a situation in which a court would validate a *disposition which* is impeachable at common law.

(h) Company need not positively benefit

It is not essential that the disposition should positively benefit the company:

> 'In the instant case the facts are such that the transaction under consideration can have no adverse effect on the asset structure of the company and can in no way prejudice any of the company's creditors. It was submitted by Mr Masterson, however, that this is not enough, and that the power granted by the section should only be exercised when the Court is satisfied that to do so would operate to the positive benefit of the company. That seems to me to put much too narrow a construction on the provision. Where there is no lack of good faith, and where considerations of fairness (which include considerations of any adverse effects on the company's creditors) support the relief sought, I see no reason why it should be a further and separate requirement that the desired relief must in addition positively operate to the benefit of the company'

(per Beck JA in Commercial Grain Producers Association v Tobacco Sales Ltd(214)).

(i) Company should not be enriched

It is no part of the policy of s 341(2) that the company should be enriched at the expense of the disponee, the object of the section being to prevent the dissipation of the company's assets, not to improve the company's position at the expense of others:

> 'If even bona fide transaction for a consideration would not be protected then the Company, only by the fact that the process of winding up has started, would benefit itself by unjust enrichment'

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(214) 1983(1) SA 826 (ZS) at 831B-C. This case related to a transfer of shares in the company against which a winding-up application had been presented - such a transfer also requires the sanction of the court under s 341(1) and its Zimbabwean counterpart - but the principle is, it is considered, equally applicable to a disposition by the company. Cf too Re Gray's Inn Construction Co Ltd [1980] 1 All ER 814(CA) at 820b-c.

(Khanna v Ghosh[215]).

(j) Decision taken as a matter of urgency

If a decision to enter into a transaction which is believed to be in the interests of the creditors has to be taken as a matter of urgency, the court is less likely to decline to validate the transaction on the ground that the belief proves to be incorrect.[216]

(k) Pressure by the disponee

If the disponee applies pressure to the company and the company succumbs and makes the required disposition, is this a factor in favour of, or adverse to, validation? Several situations must be distinguished.

(i) Threat of cancellation

If a creditor is in a position to cancel a valuable contract and threatens to do so unless he is paid, the court may obviously be expected to validate the payment in an advance application:

> 'In Re A I Levy Holdings Ltd ([1963] 2 All ER 556, [1964] Ch 19) the court validated a sale of a lease which was liable to forfeiture in the event of the tenant company being wound up, and also validated, as part of the transaction, payment out of the proceeds of sale of arrears of rent which had accrued before

(215) 1976 MhLJ 150 (Bombay) at 154. See too In re Clifton Place Garage Ltd [1970] Ch 477 (CA) at 487H, 491D and 492E.

(216) See eg In re Clifton Place Garage Ltd supra at 493A-F; Re Omnico Ltd (1976) 1 ACLR 30[illegible]0(25-30).

> the presentation of the petition for the compulsory liquidation of the company. If that case was rightly decided, as I trust that it was, the court can in appropriate circumstances validate payment in full of an unsecured pre-liquidation debt which constitutes a necessary part of a transaction which as a whole is beneficial to the general body of unsecured creditors'

(per Buckley LJ in Re Gray's Inn Construction Co Ltd[217]).

If application for validation is made ex post facto the position is more difficult. The danger of cancellation has passed and the court may therefore be reluctant to validate the preferential payment to the creditor. Against this, however, it must be borne in mind that a creditor's right of cancellation may have been an important right enjoyed by him for the protection of his interests, and to apply s 341(2) in such a way as to retrospectively deprive him of this protection may operate harshly on the creditor.

If, for example, there is a lapse of some months between the date of presentation of the winding-up application and the date of grant of the winding-up order and the company continues to pay its rent during this period it would be harsh on the landlord if the court were to refuse validation of the payments. It is doubted, however, whether a general rule can be deduced from this that whenever a disposition is made under threat of cancellation the disposition will be validated. The reason why the rent payments should be validated is, it is suggested, that the landlord continued to perform his obligations under the lease on the strength of the rent payments. Had the payments not been made he would have cancelled the lease and re-let the premises. In a sense, therefore, he relied on the payments in not doing so, and justice and fairness accordingly require that he should not be prejudiced by the payments

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(217) [1980] 1 All ER 814 (CA) at 821d-e.

being avoided.[218] Similar considerations apply to payments under other contracts where the other contracting party's obligations are continuing ones eg employment contracts, hire-purchase agreements, building contracts, etc.

The position is, however, different where the other contracting party's obligations are not of a continuing nature. For example, if a supplier sold and delivered goods to the company prior to presentation and after presentation the company paid the purchase price under threat of cancellation of the sale, validation would, it is thought, not be appropriate. There was no reliance by the supplier on the payment in performing his obligations under the sale, and the only effect of validation of the payment would be to confer a preference on the supplier.

Where arrears have already accumulated under a continuing contract prior to presentation should payment of the arrears be validated? The answer is, it is thought, that validation should generally not be granted, save to the extent, if any, the payee may have acted to his prejudice in reliance upon the payment.

This last question arose in In re Répertoire Opera Co.[219] The company had the right to represent an opera against payment of a royalty and after presentation paid certain arrear royalties to avoid cancellation of the contract. There appears to have been no evidence that the grantor of the right of representation acted to its prejudice in any way in reliance upon the payment. The court refused to validate the payment but added a rider that the liquidator had to undertake to pay to the grantor any money - in

(218) Cf 567-60 above.

(219) (1895) 2 Mans 314.

effect any profit - he might receive under the contract up to the amount ordered to be repaid by reason of the non-validation.

The validity of the order attached by the court to its order may, however, be questioned. If the court's approach is correct it would follow, it is thought, that whenever a creditor has received payment after presentation he would be entitled to validation up to the amount of any profit made by the liquidator arising out of the transaction. Such an approach would not, it is believed, be sound.

(ii) Threat of refusal to enter into further transactions

If a creditor is only willing to enter into further transactions essential for the continued conduct of the company's business on condition that a preferential payment is made to him on account of his existing claim, the court may be expected to validate the payment in an advance application provided that the transaction as a whole is beneficial to creditors:

> 'If ... it were in the interests of the creditors generally that the company's business should be carried on and this could only be achieved by paying for goods already supplied to the company when the petition is presented but not yet paid for, the court might think fit in the exercise of its discretion to validate payment for those goods'

(per Buckley LJ in Re Gray's Inn Construction Co Ltd(220)).

Where application for validation is made ex post facto a dilemma similar to that dealt with in the preceding section arises. The danger of the creditor's refusing to enter into further transactions and thus paralysing the company's business has passed and the court

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(220) [1980] 1 All ER 814 (CA) at 820e. Cf, too, Re Falkiner Chains (Pty) Ltd (1981) 6 ACLR 94 (Qld) at 95-6.

may therefore well be reluctant to validate the preferential payment to the creditor. Against this, however, it must be borne in mind that the creditor was only willing to enter into the new transactions on condition that the payment was made, and it is arguable that to apply s 341(2) in such a way that he is held bound to the new transactions while the condition on which he relied in entering into them is avoided would be harsh on him. This dilemma has arisen in a number of cases.

In In re The Civil Service and General Store Ltd[221] a supplier had insisted on part payment of its existing claim in addition to payment in cash for new goods supplied, before agreeing to supply further goods. In an ex post facto application the court validated the payment for the new goods, but refused to validate the payment in reduction of the existing claim despite the fact that a refusal to supply would have greatly injured the company. In refusing validation of the part payment of the existing claim, Chitty J said[222] that to have granted validation would have been:

> 'to act in the very teeth of the Act of Parliament, the object of which is that creditors should be paid pari passu.'

In Official Liquidators Gorakhpur Electric Supply Co Ltd v Siemens (India) Ltd[223] Siemens was owed a debt by the company at presentation and thereafter the company paid the debt. It was argued, in an ex post facto application, that the payment should be validated because Siemens was the supplier of spare parts essential to the company's business. Siemens did not in fact supply any further parts. In refusing validation the court said:[224]

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(221) (1888) 57 LJ Ch 119.

(222) At 120.

(223) AIR 1940 Allahabad 514.

(224) At 516.

'It seems to me that this argument, if analysed, is based on an alleged principle that any creditor who can bring pressure to bear on a company should have preference over a creditor who cannot. This is a principle which I consider no Court could accept.'

On the other hand, in Albion Reid (SA) (Pty) Ltd v Baron Holdings (Pty) Ltd[225] the court appears to have come to the opposite conclusion. The only supplier of concrete refused to supply further concrete to a contractor in the middle of a contract unless security were furnished for both the existing indebtedness and the future indebtedness. The company duly furnished the security. This all occurred prior to presentation, but after presentation the company requested the supplier to agree to the substitution of a new, lesser, security. The supplier agreed and the issue before the court was whether the new security should be validated. The court held that it was entitled to have regard to the circumstances surrounding the furnishing not only of the new security but also of the old security, and in regard to the old security the court held:[226]

'... when the defendant executed the mortgage ... it was looking down the barrel of a rifle held by the plaintiff .... But even so I am not satisfied that the plaintiff was making an unconscionable use of its economic power .... The Plaintiff was providing a substantial and valuable quid pro quo, without which the project must have ground to a halt .... I am not satisfied therefore that there was anything unfair in the plaintiff's actions...'

Although it does not necessarily follow that the court's conclusion would have been the same if presentation had occurred before the first security was furnished, it does appear from the court's reasoning that its decision would have been similar.

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(225) (1973) 7 SASR 564.

(226) At 568-9.

Which approach are the courts of this country likely to adopt in relation to s 341(2)? The answer is, it is suggested, that they are likely to favour the approach in the Civil Service case. True, this will have the effect that such a disposition will be validated if application is made in advance for validation but not if application is made ex post facto; however, the only reason why validation will be granted in an advance application is that the court has no option but to allow the creditor to use his economic power to force a preferential payment to himself. In an ex post facto application, on the other hand, the court has the power to avoid this happening and to ensure that creditors benefit pari passu, and it is thought that the courts will do so.

The Albion Reid case was, it is suggested, correctly decided but for the wrong reasons. The court should not, with respect, have had regard to the circumstances surrounding the furnishing of the old security.(227) Had this security not been replaced it would not have been subject to such scrutiny and it is considered that it was not appropriate for the court to subject it to scrutiny simply because it was replaced. The correct approach would have been for the court to have accepted the validity of the old security and to have validated the new security on the ground that the supplier relied on the new security in releasing the old security.(228) That validation was called for on the facts seems clear, but having erroneously held that it should scrutinise the first mortgage the court was compelled to find a reason for holding that the first mortgage also warranted validation despite the fact that it obviously preferred the mortgagee. The court's reasoning therefore seems forced and, with respect, fails to convince.

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(227) See further 575-6 below.

(228) Cf 557-60 above.

Does it make a difference if it turns out that the benefit flowing to the general body of creditors from the preference exceeds the *prejudice flowing* therefrom? Could this be the essential difference between the Civil Service and Gorakhpur cases - in both of which it seems clear that the creditors did not benefit overall - and the Albion Reid case in which it may well be that the creditors did benefit overall although there is no statement to this effect in the judgment?

Clearly, if the creditors do not benefit overall as a result of the preference the court is unlikely to validate it; however, the position is less clear where they do in fact benefit. Nevertheless, it is thought that even where the creditors do benefit validation of the preference should be refused. The preferred creditor *used his* economic power to force a preference in his favour and such an action should not lightly be validated. Moreover, *even if the* preference is not validated the creditor concerned will still benefit from the fact that *he assisted the company in* that the dividend he, as a creditor, will receive will be greater than it would have been *had he not assisted the company*, and this increased dividend is, it is suggested, all that he is in justice and fairness entitled to.

(iii) Threat of legal action

A disposition made under the threat of legal action by the creditor is not, it is considered, either more or less likely to be validated than a similar disposition not made under such a threat.[229] Even where the disposition is made to gain time to

(229) See eg Re J Leslie Engineers Co Ltd [1976] 2 All ER 85 (Ch) at 88e and 95b-c.

sell the company's business as a going concern or for any other beneficial purpose, this will not, it is thought, be regarded by the court as a factor favouring validation of the payment:

> 'And it may be in the general interests of all the creditors that time should be given, but that is not necessarily a reason why a particular creditor should receive a special benefit to do what is in the interests of all creditors to do, including himself'

(per Marten CJ in Tulsidas v Industrial Bank of Western India[230]). If a creditor presses for payment of his debt while a winding-up application is pending against the company, the appropriate action is for the company to apply under s 354(1) for a stay of the proceedings.[231]

(l) No objection from interested parties

In Re Omnico Ltd[232] the court had regard to the fact that none of the interested parties raised any objection to the transaction.

(m) Past consideration not sufficient

In Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor[233] Lichtenberg J said:

> 'I do not think that the mere fact that the payment which was made by the company in liquidation ... was made in respect of

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(230) AIR 1931 Bombay 2 at 15.

(231) But see In re International Life Assurance Society Gibbs and West's Case (1870) 10 Eq 312 at 322 dealt with at 542-3 above.

(232) (1976) 1 ACLR 381 (NSW) at 391(5-10).

(233) 1980 (4) SA 669 (SWA) at 678H.

> some past transaction from which the company liquidated may have derived some benefit, is sufficient to justify the exercise of the Court's discretion in favour of the recipient of the payment expressly declared to be void by the subsection.'[234]

Clearly this must be so; the object of the section is to ensure that creditors rank pari passu and all, or at least most, of the creditors will have given value in acquiring their claims.

(n) Practical interpretation

In Kextile Holdings (Pty) Ltd v Widdows; Re Brush Fabrics (Pty) Ltd [235] the court said in relation to the Australian counterpart of s 341(2):

> '... a practical interpretation of s. 227 should be made so that the section will operate in a commercial way.'

(o) Preceding circumstances

The court is not limited to a consideration of the immediate circumstances surrounding the disposition in question but may in addition have regard to the circumstances giving rise to the disposition. An extreme example of this is to be found in Albion Reid (SA) (Pty) Ltd v Baron Holdings (Pty) Ltd.[236] The holder of a mortgage bond passed by the company agreed, without being aware that a winding-up petition had been presented against the company, to the cancellation of the bond and the registration of a new bond in lieu thereof and the court held that it was entitled to have regard to the circumstances in which the first bond was registered

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(234) See also Re J Leslie Engineers Co Ltd [1976] 2 All ER 85 (Ch) at 95b.

(235) [1974] VR 689 at 696(10).

(236) (1973) 7 SASR 564.

despite the fact that such registration took place prior to the presentation of the winding-up petition. In the event the court validated the registration of the new bond, but had it refused to do so on the ground of some objectionable circumstance relating to the registration of the old bond this would, it is suggested, have been to take the scope of the court's discretion too far.

(p) Dilatory tactics on the part of the company

The fact that the company employed dilatory tactics preventing the disponee's obtaining and executing judgment until after presentation will not avail the disponee.(237)

(q) Acceptance by disponee of reduced payment in settlement

The fact that the disponee accepted payment of part of his claim in settlement of the whole claim and that the company therefore benefited to the extent of the reduction in the claim will not avail the disponee if he was nevertheless paid more than the dividend he would have received on his full claim.(238)

(r) Disponee was the applicant for winding-up

The fact that the disponee was the applicant for winding-up has been held to be a factor adverse to validation. Thus in In re Liverpool Civil Service Association Ex p Greenwood(239) the petitioning creditor agreed in consideration of a part payment on account of its claim and an undertaking to pay the balance by a

(237) Official Liquidators Gorakhpur Electric Supply Co Ltd v Siemens (India) Ltd AIR 1940 Allahabad 514 at 516.

(238) Ibid.

(239) (1874) 9 Ch App 511 at 512-13. See too Tulsidas v Industrial Bank of Western India AIR 1931 Bombay 2 at 9-10, 14, 20 and 21.

certain date to postpone the winding-up petition but when the balance was not paid proceeded with the petition. The court refused to validate the part payment saying :

> '...the question is, whether the very creditor who has prosecuted the petition should be allowed to retain money which he has obtained by means of the petition, when the result of the petition is that the assets of the company are to be divided equally amongst its creditors.
>
> '... the creditor insists on the Court making a winding-up order on the ground that at the time when he presented his petition the company was unable to pay its debts, and therefore ought to be wound up, and that the assets ought to be divided amongst the creditors. It appears to me that a creditor of this kind avers that he is willing to come in and take an equal share with all the other creditors, and that he should not be allowed to take advantage of the Act, and get payment on the ground that the company is unable to pay its debts, and at the same time receive a greater proportion than the other creditors. In all bankruptcies and winding-up proceedings a creditor who successfully avails himself of those proceedings cannot be allowed to receive more than his share of the assets, and must come in equally with all the other creditors.'

With respect, however, it is doubted whether it made any difference that the disponee was the petitioning creditor. The payment constituted the preferential discharge of portion of the creditor's claim and would therefore not have qualified for validation even if the creditor had not been the petitioning creditor.(240)

(s) Conclusions

What conclusions can be drawn from the aforegoing? No general tests of universal application can, it is believed, be formulated. Nevertheless, it is considered that it is possible to formulate general guidelines which will apply in most situations.

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(240) See 497-514 and 557-60 above.

(i) Advance applications

The following criteria for validation are suggested in regard to advance applications:

(A) If the proposed disposition is in the interests both of the creditors and of the shareholders it will be validated;

(B) If the proposed disposition is in the interests of the shareholders but not of the creditors the conflicting interests of the shareholders and creditors must be weighed up as follows:

- The greater the prospects of success in the winding-up application the greater the weight that should be attached to the creditors' interests; conversely, the less the prospects of success the greater the weight that should be attached to the shareholders' interests;

- If there is no clear indication as to the prospects of success in the winding-up application, the court should rather err in favour of the shareholders;

- The extent of the potential prejudice to the shareholders if validation is not granted should be weighed up against the extent of the potential prejudice to the creditors if it is granted;

(C) The interests of other persons such as the company's employees or even the community at large may carry some weight;

(D) The interests of the disponee are irrelevant;

(E) If validation is appropriate in accordance with the aforegoing criteria, it does not matter that the disposition may not be in

the ordinary course of business or may prefer one creditor over the others;

(F) The creditors' interests are primarily that the company's assets should not be dissipated and that certain creditors should not be preferred over others;

(G) The shareholders' interests are primarily that the company's business should not be paralysed or harmed by the mere fact that a winding-up application has been presented;

(H) In an application for the validation of the continued conduct of the company's business the court may be expected to lay down conditions to minimise the potential prejudice to the company's creditors and to endeavour to ensure that the business is only continued as long as there is no material change in the balance between the interests of the shareholders and creditors. For example, the court may stipulate for safeguards to ensure that:

- Only transactions in the ordinary course of the company's business are entered into;

- Preferential payments are not made to some creditors and not others except in circumstances in which the payments would have qualified for validation in accordance with the criteria set out above;

- The business is only continued if, and for as long as, the assumptions on which the court's order was based prove to be correct.

The court may well require that the observance of any conditions it lays down be monitored by an independent person such as a chartered accountant.

(ii) Ex post facto applications

The following criteria for validation are suggested in regard to ex post facto applications:

(A) If validation is in the interests of the creditors the court will grant a validation order; however, the fact that a transaction as a whole may have been in the interests of the creditors does not necessarily entail that validation of the discharge by the company of its obligations under the transaction will be in the interests of the creditors eg the purchase of stock needed to continue the company's business may have been in the interests of the creditors whereas the payment of certain suppliers but not others would not be;

(B) If validation is not in the interests of creditors, validation should nevertheless be granted in the following circumstances:

(01) If the disposition consisted of the conclusion of a normal, arm's length contract the contract should be validated unless the disponee knew, or ought to have known, at the time of the conclusion of the contract that the contract was not in the interests of the creditors, except that if the shareholders' interests would have taken precedence had application for validation been made in advance, and the disponee knew this and relied on it, validation should not be refused on the ground that he knew that the contract was not in the interests of creditors;

(02) If the disposition consisted of the discharge of an obligation by the company the discharge should be validated if, and to the extent, the disponee relied on the discharge by the company of the obligation in himself discharging an obligation owed by him to the company, or in undertaking and discharging such an obligation, unless the disponee

knew or ought have known at the time of relying on the discharge by the company of the obligation that the discharge by the company of the obligation and his reliance thereon was not in the interests of creditors, except that if the shareholders' interests would have taken precedence had application for validation been made in advance, and the disponee knew this and relied on it, validation should not be refused on the ground that he knew that the discharge by the company of its obligation and his reliance thereon was not in the interests of creditors;

(03) Where a series of transactions occurs after presentation validation should not be refused if this would result in the disponee's claim exceeding the highest amount it rose to after presentation, even if the disponee did not specifically rely on the discharge of earlier debts in granting new credit, eg if at presentation a company had utilised R2 000 of its overdraft facility of R10 000 and the overdraft thereafter rose to R4 500 before being reduced to R2 000 again as a result of various deposits and withdrawals totalling R8 000 in each case, deposits totalling R5 500 should be validated so that the bank is left with a claim of R4 500 in the winding-up. The remaining deposits totalling R2 500 should not be validated as this would prefer the bank over other post-presentation creditors and over pre-presentation creditors;

(04) If the disposition consisted of the discharge by the company of its obligations under a continuing contract such as a lease and but for the discharge by the company of its obligations the other party would have cancelled the contract, the discharge by the company of its obligations should be validated because the other party relied on such discharge in continuing to discharge his own obligations under the contract;

(05) If the disponee's motive in entering into a contract was to benefit the creditors or the company this may influence the court to validate both the contract and the discharge by the company of its obligations under the contract even if the contract or discharge would not otherwise qualify for validation, especially if the disponee ran the risk of personal loss. For example, if a director of the company lent it money because he believed that the loan might enable it to trade out of its difficulties and that at worst the loan would enable the business to be continued and in due course to be sold as a going concern to the benefit of all concerned, the court would be likely to validate both the contract of loan and such repayments as might have been made on account of the loan. The fact that the contract does not achieve its object is not a bar to validation but may result in less weight being attached to the disponee's motives. If the disponee's belief that he was acting in the interests of the creditors or the company was unreasonable, the court is likely to attach still less weight to the disponee's motives;

(C) If a decision had to be taken urgently the court is less likely to find that the disponee should have known that it would not be in the interests of creditors.

(7) Validation of the continued operation of a bank account

There are a number of reported cases in other countries under their counterparts of s 341(2) on the validation of the continued operation of a bank account and these cases will be examined first before tests of general application to the validation of the continued operation of the company's bank account are suggested.

The most important of these cases is the Gray's Inn case which must, it is considered, be taken as having overruled to a greater or lesser extent many of the earlier cases on validation. This case will therefore be dealt with first and the other cases will be dealt with thereafter in chronological order.

(a) Re Gray's Inn Construction Co Ltd

The facts in Re Gray's Inn Construction Co Ltd[241] were as follows. The bank had granted the company an overdraft facility of £5 000 and on presentation of the winding-up petition against the company the overdraft in fact slightly exceeded this amount, standing at £5 322. Throughout the period between presentation and the grant of the winding-up order deposits were made to, and withdrawals were made from, the account. On the grant of the winding-up order the overdraft stood at £4 464 made up as follows:

£ 5 322	-	Overdraft at presentation
24 129	-	Withdrawals between presentation and the order
326	-	Interest and bank charges
29 777		
25 313	-	Deposits between presentation and the order
4 464		

Between presentation and the order the account was at all times in overdraft, the balance owing fluctuating between about £3 600 and about £7 000.

At first the bank was unaware of the presentation of the petition and during the period between presentation and the date the bank became aware of the presentation £2 670 was deposited to the

(241) [1980] 1 All ER 814(CA).

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account. The withdrawals during the same period exceeded this amount. When the bank became aware of the presentation of the petition it agreed to the continued operation of the account on being satisfied that the continued conduct by the company of its business would be in the interests of the creditors in that the company was in a position to trade at a profit, and on condition that cheques[242] were only drawn in the ordinary course of business. The bank's belief that the company would be able to trade at a profit was reasonable but it did not institute any safeguards to ensure that the company only continued to operate its bank account as long as it did in fact make a profit, and in the event the company made a loss of £ 5 000. The bank also did not institute any safeguards to ensure that preferential payments were not made to some pre-presentation creditors[243] at the expense of other pre-presentation creditors, and £4 824 was in fact paid to certain pre-presentation creditors.

The liquidator initially claimed £25 313 being the total of all the credits to the account, or alternatively £24 129 plus £326 being the total of all the debits to the account, but at the hearing he limited his claim to the amount of the trading loss ie £5 000. The court upheld the liquidator's claim as so reduced - the court described[244] the liquidator as being 'moderate in his demands' - but at the same time indirectly validated, by a process of reasoning described below, the reduction in the bank's claim arising from the

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(242) The view has already been taken - see 161ff above - that s 341(2) of our Act only applies to payment instructions other than cheques in view of the provisions of s 73(c) of the Bills of Exchange Act.

(243) Buckley LJ refers to them as 'pre-liquidation creditors' but it is clear that he uses this expression in the sense of pre-presentation creditors - see eg at 821b.

(244) At 825g.

fact that the deposits to the account exceeded the withdrawals by £1 184 (£25 313 less £24 129); in other words, the net effect of the court's order was that the bank was £3 816 (£5 000 less £1 184) worse off than it would have been had the account been frozen on presentation. The process of reasoning by which the court arrived at this conclusion is complex and is analysed in what follows.

The court held[245] all deposits to the account and all payments out of the account to third parties to be void dispositions under the English counterpart of s 341(2) and that the bank was therefore vulnerable to an order to reimburse both the £25 313 and the £24 129 to the liquidator.[246] Insofar as deposits are concerned this is clearly correct,[247] but insofar as withdrawals are concerned the view has already been taken[248] that payments to the company are not dispositions by the company of its property and are therefore unaffected by s 341(2) and its counterparts elsewhere, and that payments to third parties must be analysed into 2 payments: a payment by the bank to the company which is not such a disposition and a payment by the company to the third party which is such a disposition but which is recoverable from the third party, not the bank.

In dealing with the question of validation the court held[249] that if a bank is requested by a company to continue to allow the

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(245) At 818e-j.

(246) The court rejected the argument that regard should only be had to the net excess in the deposits over the withdrawals, holding that each transaction had to be looked at separately (at 818j).

(247) See 423-4 above.

(248) See 375-91 above.

(249) At 820c and 819c-d.

company to operate its bank account after presentation the bank must weigh up the likely benefits and dangers of the company continuing in business against the benefits and losses which may be the consequence of an immediate cessation of business, with a view to determining whether the risks of allowing the company to continue in business are worth taking in the interests of the company[250] and its creditors. Moreover, if it does appear to be in the interests of the company and its creditors that the company should continue in business the bank must institute safeguards[251] to ensure that:

- cheques are only drawn in the ordinary course of the company's business;[252]

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(250) It is not clear whether or not the court had in mind the shareholders in referring to the 'company' and what its attitude would have been had the interests of the shareholders and creditors been in conflict - see further 517-23 above.

(251) The court recognised (at 822b) that foolproof safeguards are not practicable:

> 'A bank cannot, of course, spend all or even a great deal of its time in conducting a day-to-day surveillance of a customer's business, and the court.... must do its best to make a realistic assessment of the risk involved of any system of safeguards falling short of failing safe.'

(252) The court apparently considered that appropriate personal assurances from the directors would be a sufficient safeguard:

> '[The bank] can require personal assurances from the directors of the company that no payments out of the new account will be made in discharge of pre-liquidation debts and that all payments out of the new account shall be in respect of liabilities incurred in the ordinary course of business subsequent to the presentation of the petition' (at 822g).

The bank would no doubt need to have reasonable grounds for relying on the integrity and competence of the directors - cf the judgment of the court a quo quoted at 823h.

- preferential payments are not made to some pre-presentation creditors at the expense of the others;[253]

- the company only continues to trade as long as such continued trading in fact proves to be in the interests of the company and its creditors.[254]

Is it justified to place this onus on the bank? The requirement of good faith has been considered above[255] and the conclusion reached there was that if the disponee knew or ought to have known that the proposed dealings would not be in the interests of the creditors, validation would clearly be inappropriate (unless the shareholders' interests would have taken precedence had application been made in advance for validation and he knew this and relied on it); however, it is another matter to place an onus on the person proposing to have the dealings with the company to investigate whether the proposed dealings will be in the interests of the creditors and, where there will be a series of dealings, to monitor that the dealings in fact prove to be in the interests of the creditors.

To impose such an onus on a bank or other person proposing to have dealings with the company is, with respect, to go too far towards protecting the creditors at the expense of the disponee. Moreover, the imposition of such an onus is likely to be

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(253) See the previous note. See also at 823d.

(254) The court did not suggest what precautions it would have regarded as adequate for this purpose - see at 822g and 825f.

(255) See 526-45 above.

counterproductive. Few persons may be expected to be willing to have dealings with a company if they are expected to accept such an onus,[257] with the result that the company may be forced to apply for advance validation. The disadvantages of forcing a company to bring an advance application have already been dealt with above[258] and need not be repeated here.

It is also significant that in no previous case had any such onus been imposed on a bank or any other person. In In re Clifton Place Garage Ltd,[259] for example, the company's parent company in effect acted as its banker but in validating all transactions on the account between the companies the Court of Appeal did not investigate whether the payments made by the parent company did not perhaps constitute preferential payments to certain creditors at the expense of others.[260]

The court was satisfied that the weighing-up exercise referred to above had in fact been carried out and that the bank had reasonably concluded that it was in the interests of the company and its creditors to continue in business. The court was also satisfied

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(257) F R Ryder 'Payment of cheques after presentation of petition to wind up' 1980 JBL 189; E Ovey 'Bank in quandary if it learns of petition against company client' (1980) 1 Company Lawyer 147.

(258) See 550 above.

(259) [1970] Ch 477 (CA) - see further 597-500 below.

(260) Cf too Re Steane's (Bournemouth) Ltd [1950] 1 All ER 21(Ch) at 24G - 25B; Re KVE Homes (Pty) Ltd (1979) 4 ACLR 47 (NSW); Re Falkiner Chains (Pty) Ltd (1981) 6 ACLR 94 (Qld). The last 2 cases were advance applications for the validation of the continued conduct by the company of its business but the court did not lay down any conditions such as those required in the Gray's Inn case.

that the bank had instituted the first safeguard mentioned above, namely that cheques were only drawn in the ordinary course of the company's business. No attempt had, however, been made to institute the other 2 safeguards.

As the bank had failed to institute safeguards to ensure that preferential payments were not made to some pre-presentation creditors at the expense of the others the court held[261] that the bank was vulnerable to a refusal to validate the payments totalling £4 824 in fact made to pre-presentation creditors, at least to the extent the payments made exceeded the dividends the creditors would in any event have received. Despite this, the court validated[262] the payments totalling £4 824 vis-à-vis the bank, saying that primarily the payments should be recovered from the payees.[263]

Turning to the trading loss, the court held[264] that inasmuch as the bank had failed to institute any safeguards to ensure that

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(261) At 823d-e.

(262) At 823e-f and 826a.

(263) But cf Re J Leslie Engineers Co Ltd [1976] 2 All ER 85(Ch) at 95h-j in which Oliver J said:

> '... I cannot think that the existence of an alternative remedy against somebody else can be a good reason for validating a transaction.'

Presumably, if the liquidator had tried unsuccessfuly to recover the payments from the payees the court would have ordered the bank to make payment. The question of whether it is competent for the court to validate a disposition vis-à-vis only one of 2 parties liable to reimburse the disposition has been considered at 492 above and the view taken was that it is not competent for the court to do so.

(264) At 825f.

the company only continued to trade as long as it did so at a profit the bank should bear the loss and the court accordingly refused to validate £5 000 of the deposits to the account.(265)

The court also distinguished the deposits made to the account between presentation and the date on which the bank became aware of the presentation from the deposits made thereafter. The deposits before the bank became aware of the presentation totalled £2 670 and the court validated them, apparently on the sole ground that the bank was unaware of the presentation at the time they were made.(266) It is difficult, however, to accept that absence of knowledge of the presentation is a valid reason for validating the preferential discharge of one pre-presentation creditor's claim at the expense of the other pre-presentation creditors. If a company makes a number of preferential payments to pre-presentation

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(265) It may be noted that the court a quo had held (at 824j):

> 'In my judgment the circumstances of this company were such that harm would have resulted if the company had ceased to trade on [presentation or on the date on which the bank became aware of the presentation] .... It is not certain that any greater harm resulted from the decision to continue in business than the harm which would have been suffered if the company had ceased to carry on business.'

The Court of Appeal apparently accepted this finding (at 826b) and there was therefore no evidence that the creditors suffered any loss as a result of the bank's actions. Why, then, the Court of Appeal considered that the bank should make good the trading loss is unclear, unless the court considered that the bank bore, and had failed to discharge, the onus of showing that the loss that would have resulted from the immediate cessation of business would have equalled or exceeded the trading loss. There is, however, no mention of this question having been decided on onus. Cf In re Clifton Place Garage Ltd [1970] Ch 477(CA) especially at 492E-G.

(266) At 822j - 823a.

creditors, why should those creditors who were unaware of the presentation be entitled to retain their payments while the others must return theirs?[267]

True, during the same period the withdrawals exceeded the deposits, and had the position not changed before the grant of the order this would, if the bank relied on the deposits in permitting the withdrawals, have constituted a good reason for validating the deposits.[268] However, during the period from the date on which the bank became aware of the presentation to the date the order was granted the position was reversed with the result that during the full period from presentation to the grant of the order the deposits exceeded the withdrawals. The effect, therefore, of the court's order - the court also validated[269] all other debits and credits to the account - was that the reduction in the overdraft between presentation and the grant of the order was validated. In other words, the actual benefit to the bank of this part of the court's order was £1 184 (£25 313 less £24 129) and not £2 670.

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(267) The court's approach seems all the more surprising because it had expressly said (at 820d):

> '... it is, in my opinion, clear that the court should not validate any transaction or series of transactions which might result in one or more pre-liquidation creditors being paid in full at the expense of other creditors, who will only receive a dividend, in the absence of special circumstances making such a course desirable in the interests of the unsecured creditors as a body.'

See further 536-41 above.

(268) See 557-60 above.

(269) At 826a.

A further effect of the court's validation of all other debits and credits to the account was that the bank's claim for the bank charges and interest was validated. The court did not give any specific reason for validating the other debits and credits, although it did refer generally in the course of the judgment to a wide range of factors relevant to the exercise by the court of its discretion to validate or not.

A further difficulty with the court's approach is that the court appears[270] to have assumed that the bank could simply have frozen the customer's account on becoming aware of the presentation of the winding-up petition against the customer. This assumption is challenged below[271] where the view is taken that reasonable notice must be given before the account is frozen, that the bank is obliged to continue to honour payment instructions during this period and that the fact that the bank is obliged to do should normally entitle it to validation.

What would have constituted a reasonable period of notice of intention to freeze the account and what cheques were honoured during this period do not appear from the reported facts. On the reported facts, the appropriate decision, with respect, would have been for the court to have validated all credits to the account save to the extent they reduced the bank's claim from the high of £7 000 to which the bank allowed it to rise after presentation.[272] As the claim had been reduced to £4 464 by the time the winding-up order was granted the bank would have had to refund £2 536 (£7 000 less £4 464) on this approach leaving it with a claim of £7 000 against the estate.

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(270) See eg at 822f-g.

(271) See 633-46 below.

(272) See 560-1 above.

(b) In re International Life Assurance Society Gibbs and West's Case

In re International Life Assurance Society Gibbs and West's Case[273] has been considered above[274] and it is not necessary to deal with it in detail again here. The company had after presentation given security to its bankers for their pre-presentation claim in order to gain time to sell its business. Had this been the only consideration validation would, it is thought, have been inappropriate because the appropriate procedure would have been for the company to have sought a stay under the English counterpart of s 358 of any proceedings the bankers might have instituted. This would have achieved the same object without preferring the bankers over other creditors. However, there was a further consideration, namely that the directors had at the same time given their personal guarantees to the bankers in the belief that their actions were in the best interests of the creditors. Non-validation would therefore have prejudiced the directors, not the bank, which would have been harsh on them as their motive for acting as they did was to benefit the company even at the risk of personal loss. The court validated the security.

(c) Millar v The National Bank of Scotland Limited

In Millar v The National Bank of Scotland Ltd & Others[275] the company had after presentation first deposited money with the bank and thereafter withdrawn portion of it again. The company also had an overdrawn account but the deposit was credited to a separate account. The liquidator sued for the full amount of the deposit and the bank tendered the net amount after the withdrawls. The court upheld the liquidator's claim.

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(273) (1870) 10 Eq 312.

(274) See 542-3 above.

(275) (1891) 28 ScLR 884.

The decision, however, largely turned on a statutory provision applicable only to Scottish windings-up providing that the commencement of a winding-up had the effect of an attachment of the company's property in the hands of third parties and an order to make the property available.[276] Despite this statutory provision the bank argued that the court could and should validate the withdrawals under the Scottish equivalent of s 341(2). The court doubted whether the section applied to the case but held that in any event:[277]

> '... to sustain the claim of the bank would be to sin against the cardinal principle of the Act, viz., the pari passu ranking of creditors. In regard to the sums drawn out of the account, there is no reason to suppose that the draft was allowed because of the payment of the £718 into the account. And further, if the bank, after it ought to have known of the presentation of a winding-up petition, chose to allow drafts, it must, I think, take the consequences.'

Any attempt to apply the decision to the situation in this country would encounter numerous objections: there is no provision in our Act equivalent to the Scottish provision mentioned above; a payment out of the account to the company is not a disposition by the company and although a payment to a third party in accordance with the company's directions is a disposition to the third party the disposition is recoverable from the third party, not the bank; the bank was a debtor in respect of the account concerned and it is therefore difficult to see the relevance of the principle of the pari passu ranking of creditors; the effect of the court's order appears to be that the creditors were unjustly enriched at the bank's expense; generally where a bank allows a withdrawal from an account in credit there will be good reason to suppose that the withdrawal was permitted because of the credit; in this country the

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(276) See 262 above.

(277) At 889.

presentation of a winding-up application is not advertised so that it would not normally be possible to say that the bank ought to have known of the presentation; and the court did not consider whether the bank would have been entitled to refuse to honour the company's payment instructions.

(d) Re T W Construction Ltd

In Re T W Construction Ltd[278] the bank had granted the company an overdraft facility of £1 000 and on presentation the overdraft stood at £803. Thereafter the overdraft facility was increased and the overdraft had reached £1 368 when a deposit of £1 308 was made. The bank was at all times unaware of the presentation. Wynn-Parry J validated the entire deposit on the ground that the transaction fell directly within Lord Cairns' statement in In re Wiltshire Iron Company Ex p Pearson[279] that a disposition should be validated if it is bona fide entered into in the ordinary course of the company's business which it is in the interests of everyone to preserve.

With respect, however, it is difficult to agree with Wynn-Parry J's approach. The view has already been expressed[280] that Wynn-Parry J was mistaken in interpreting Lord Cairns' statement as also applying to the discharge of pre-presentation debts, and the view has also already been expressed[281] that the preferential discharge of a pre-presentation debt should not be validated except in certain limited circumstances such as where the

(278) [1954] 1 All ER 744 (Ch).

(279) (1868) 3 Ch App 443 at 447 - see 528-9 above.

(280) See 529 above.

(281) See eg 497-514, 557-60 and 566-9 above.

recipient has relied on the discharge of the debt in giving new credit, or where it is desired to make a preferential payment in order to avoid cancellation of a valuable contract. No such circumstances seem to have been present in the T W Construction case.

Even insofar as the discharge of the post-presentation portion of the overdraft is concerned it is difficult to agree with Wynn-Parry J. The risk taken by the bank in giving credit to the company was the same as the risk taken by the other post-presentation creditors and, for that matter, by the pre-presentation creditors. It is not clear, therefore, why the bank should have been preferred over these other creditors.(282)

(e) Annadra Bank Ltd v Narayana Rao

In Annadra Bank Ltd v Narayana Rao(283) the bank after presentation of a winding-up petition against the company lent and advanced monies to the company against security furnished by the company. The bank was unaware of the presentation. The court refused to validate the security on the ground that the company was aware at the time that there was no possibility of its continuing to carry on its current business in the ordinary course and there was therefore

(282) The court distinguished In re Liverpool Civil Service Association Ex p Greenwood (1874) 9 Ch App 511 on the ground that the question in that case was whether the very creditor who has prosecuted the petition should be allowed to retain money which he had obtained by means of the petition, but, with respect, the only relevant criterion is that creditors should rank pari passu - see 576-7 above. The court also distinguished In re The Civil Service and General Store Ltd (1888) 57 LJ Ch 119 on the ground that when the disponee in that case received the disposition it was aware of the presentation of the winding-up petition; however, the view has already been taken at 536-41 above that this is not a material factor.

(283) AIR 1955 Madras 247.

no question of the company borrowing the monies in the ordinary course of its current trade within the scope of Lord Cairns' dictum in In re Wiltshire Iron Company Ex p Pearson.[284]

The criteria for validation enunciated by Lord Cairns have already been criticised above[285] and, with respect, the Anhadra case exemplifies precisely the wrong conclusions to which the criteria can give rise. As the bank was unaware of the presentation of the winding-up petition there was no way in which it could have ensured that the criteria were fulfilled, and to refuse the bank validation on this ground failed, with respect, to secure justice and fairness to the bank. The correct approach, it is submitted, would have been for the court to have validated the giving of the security on the ground that the bank relied on the discharge by the company of its obligation to give the security in itself discharging its obligation to advance the monies lent.[286]

(f) In re Clifton Place Garage Ltd

In In re Clifton Place Garage Ltd[287] the company's bank froze the company's account on presentation of the winding-up petition against the company. Moreover, in consequence of the presentation the debenture-holders of the company's parent company appointed a receiver to the parent company. The receiver, acting on information furnished to him by the sole director of both companies,

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(284) (1868) 3 Ch App 443 at 447 - see 545-6 above.

(285) See 545-54 above.

(286) See 557-60 above.

(287) [1970] Ch 477(CA).

decided that it would be in the interests of all concerned if the subsidiary company was placed in a position to continue its business with a view to realising it as a going concern. The decision was taken under pressure on Christmas eve and on further investigation the receiver found that the information furnished to him was incorrect. He accordingly withdrew the opposition he had previously raised to the granting of a winding-up order and the subsidiary company was placed in winding-up. In the meantime, however, he had caused the parent company from time to time over a period of about 3 weeks to advance monies needed by the subsidiary company to continue its business and about 80% of the total amount advanced had been repaid by deposits of the daily receipts to the parent company's bank account; in other words, the parent company had in effect acted as the subsidiary company's banker.

The receiver sought an order validating the deposits but the registrar refused the order. The court a quo upheld the registrar's decision but its judgment was reversed on appeal to the Court of Appeal. The Court of Appeal based its judgment on a number of factors: the receiver acted in good faith in what he reasonably believed to be the best interests of all concerned; the receiver would not have made the payments had the deposits not been 'available as a counterbalance'; and the creditors would have been unjustly enriched if the deposits had not been validated.

The decision is, it is thought, entirely correct. Had the daily takings not been deposited to the parent company's account the parent company would no doubt have refused to make the payments on behalf of the subsidiary company.(288) The receiver therefore relied on the deposits in making the payments and this fact coupled

(288) Except possibly for the first few.

with his good faith entitled him to validation in accordance with the criteria for validation dealt with above.(289)

No mention is made in the report of whether steps were taken to ensure that preferential payments were not made to certain pre-presentation creditors but it appears likely that the monies were in fact only used for current purchases, wages, etc. It also appears likely that only transactions in the ordinary course of business were entered into.

In the course of one of the 3 judgments delivered in the Court of Appeal Phillimore LJ said in relation to the English counterpart of s 341(2):(290)

> 'This is a very harsh section as applied. We are told that the first result of a petition seeking an order for the winding up of a company by the court is that its bank refuses to honour its cheque[s], although it will continue to accept receipts in its favour. It follows that, even in the case of a company where the court ultimately refuses the order, serious damage may have resulted from the petition. After all, one of the results of a petition and of such action of the bank is that a company may have great difficulty in paying its employees, and, if it does pay them, the payments if derived from the funds of the company are prima facie void. All this dates from the good old days when landlords and creditors came before anyone else. I am not suggesting that they should come after anyone else; but, in my judgment, the court should extend indulgence to any disposition by a company honestly designed to ensure that its employees are paid their wages or which was made to enable it to carry on its business and perhaps turn the corner, provided always that it was a reasonable disposition and not dishonest or reckless. I question also whether this rigid practice of the banks in all cases is right, or whether, particularly if they were aware that the court would look with indulgence on such cases, it would not be possible, after proper inquiry, at any rate in some cases, to cash cheques for a company, even if only against current receipts on a day to day basis.'

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(289) See 557-60 above.

(290) At 494 B.

Few banks in England were, however, willing to relax their attitude towards freezing a customer's account in the light of Phillimore LJ's remarks and their attitude has hardened still further since the Gray's Inn case.(291)

(g) The dispositions involved in the operation of a bank account

It is convenient to recapitulate what is said above(292) regarding the dispositions involved in the operation of a current bank account.

The deposit by a company of monies to its account constitutes a disposition by the company of those monies to the bank.(293) Where the deposit consists of a bill for collection, the disposition occurs when the bank has collected the monies and credits them to the customer's account.(294) If a bill is negotiated or ceded to the bank a disposition occurs when the negotiation or cession is perfected.(295)

The payment by the bank of monies to the company does not constitutes a disposition by the company of its property.(296) The payment by the bank of monies to a third party in accordance with the company's instructions must be analysed in 2 payments: a payment by the bank to the customer, which is not a disposition by the

(291) See 239-40 above and 633-46 below.

(292) See 375-425 above.

(293) See 423-4 above.

(294) See 423 above.

(295) See 432 and 434-6 above.

(296) See 375-81 above.

company, and a payment by the customer to the third party which is such a disposition but which is recoverable from the third party, not the bank.[297]

The giving of security by the company to the bank is a disposition whether given by way of mortgage, pledge, cession as security or notarial bond.[298] If the security secures future debts a disposition occurs as each debt is incurred.[299] If a cession as security is expressed to be a cession not only of existing debts but also of future debts, or if a notarial bond bonds not only existing movables but also future movables, a further disposition occurs as each ceded debt or bonded movable comes within the operation of the cession or bond.[300]

If a set-off occurs, the set-off constitutes a disposition whether or not it was preceded by an act on the part of the company.[301]

If, as is considered to be the better view,[302] the Insolvency Act definition of 'disposition' applies to s 341(2), a number of further dispositions are involved in the operation of a bank account. Firstly, the contract of loan that occurs when monies are deposited to an account which is in credit constitutes a

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(297) See 381-91 above.

(298) See 399-421 above.

(299) See 404-11 above.

(300) See 414-7 and 420 above.

(301) See 394-5 above.

(302) See 325-34 above.

disposition.[303] Secondly, the contract of loan that occurs when monies are withdrawn from an account which is in overdraft similarly constitute a disposition.[304] Thirdly, if any charges are payable to the bank in respect of a deposit or withdrawal the incurrence by the company of liability for the charges is a disposition.[305]

(h) Advance applications

An advance application for validation will generally be made because the company wishes to avoid the paralysis of its business, and the application will, therefore, in most cases, be made by the company itself and will be for the validation in general terms of the continued operation of the account. To succeed, the company will need to show either that the continued conduct of its business is in the interests both of the shareholders and of the creditors or that the shareholders' interests should take precedence.[306] The court may be expected to stipulate for safeguards to ensure that:

- Only transactions in the ordinary course of the company's business are entered into;

- Preferential payments are not made to some creditors and not others, except where it is in the interests of creditors to do so eg in order to procure goods and services essential for the continuation of the business or to prevent the cancellation of a valuable contract;

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(303) See 425-6 above.

(304) See 396-7 above.

(305) See 392-4 above.

(306) See 517-23 above.

- The business is only continued if, and for as long as, the assumptions on which the court's order was based prove to be correct.

The court may, moreover, well require that the observance of any conditions it lays down be monitored by an independent person such as a chartered accountant.

If the company needs an overdraft facility to enable it to continue its business and if the bank is willing to grant the facility provided that the company furnishes security, the court may be expected to also validate the security if the continued operation of the account otherwise qualifies for validation as set out above. Similarly, if the company already has an overdraft facility but needs an increased facility and if the bank is willing to grant the increased facility provided that the company furnishes security for the increase in the facility, the court may be expected to also validate the security if the continued operation of the account otherwise qualifies for validation as set out above. If the bank is only willing to grant the increase in the facility if security is furnished both for the existing facility and the increase in the facility, the company will need to show, in order to obtain validation of the security, firstly that the necessary finance is not available from another source on more favourable terms[307] and secondly either that the benefit to creditors will exceed the prejudice arising from the preference to the bank or that the shareholders' interests should take precedence.[308]

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(307) Cf Ram Lal v Official Liquidator, Benares Bank Ltd AIR 1942 Allahabad 141 at 144f-g.

(308) See 500 and 517-23 above.

(j) Ex post facto applications

Ex post facto applications will generally be made by the bank and it is convenient to deal separately with cases where the account is in credit and where it is in overdraft. The position in regard to the bank's charges is dealt with thereafter.

(i) Account in credit

(A) Deposits

If the account is in credit and a deposit is made to it a contract of loan comes into existence between the customer as lender and the bank as borrower and the deposit constitutes the advance of the monies lent. Both the contract of loan and the advance of the monies lent should be validated on the ground inter alia that there is no prejudice to creditors.(309)

(B) Withdrawals

If the company's account is in credit, withdrawals from the account constitute payments on account of the bank's indebtedness to the company, and the view has already been taken(310) that payments to the company are not dispositions by the company of its property. Insofar as payments to third parties in accordance with the company's instructions are concerned, the view has similarly

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(309) Especially if interest is payable on the monies. The position may be otherwise where the money is deposited in a fixed term or notice investment, especially if the interest rate is unfavourable, but this does not arise in the case of a current banking account. Another ground for validation would be that the contract is normal and arm's length - see 555-7 above.

(310) See 375-81 above.

already been taken[311] that such payments must be analysed in 2 payments: a payment by the bank to the company, which is not a disposition by the company of its property, and a payment by the company to the third party which is such a disposition, but which is recoverable from the third party, not the bank.

(ii) Account in overdraft

(A) Deposits

If the account is in overdraft and a deposit is made to the account the deposit constitutes a payment on account of the company's indebtedness to the bank.

If the deposit is the only transaction to take place on the account after presentation the deposit constitutes the preferential discharge of portion of the bank's claim and validation should not be granted.[312] It will not avail the bank that it was unaware of the presentation of the winding-up application,[313] or that there was no intention to give or get a preference,[314] or that the deposit was made in the ordinary course of the company's business[315] or that the bank gave an extension of time for payment of the balance of its claim in consideration of the deposit.[316]

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(311) See 381-91 above.

(312) See 499-507 and 557-60 above.

(313) See 536-41 above.

(314) See 500-501 above.

(315) See 545-54 and 557-60 above.

(316) See 573-4 above.

If there were both deposits and withdrawals, the deposits should be validated to the extent they were relied on by the bank in permitting the withdrawals.(317) If, for example, the company's overdraft facility was at all times R10 000 and both at presentation and on the grant of the order the overdraft stood at R10 000, but between presentation and the grant of the order deposits and withdrawals each totalling R6 000 were made resulting in the account's fluctuating up and down but at all times remaining within the overdraft limit of R10 000, all the deposits should be validated. If, however, the deposits had totalled R6 000 and the withdrawals R5 000 with the result that the overdraft was reduced from R10 000 to R9 000 the deposits would only be validated to the extent of R5 000.

Even where the bank did not specifically rely on the deposits, validation should not be refused to the extent such refusal would result in the bank's claim being higher than the highest level it in fact reached after presentation.(318) For example, if the company's overdraft stood at R2 000 on presentation although its overdraft facility was R10 000, and thereafter deposits and withdrawals each totalling R8 000 were made to the account with the result that the overdraft still stood at R2 000 on the grant of the order, but the balance owing had first risen to R7 000 and thereafter again been reduced to R2 000, deposits totalling R3 000 should be validated leaving the bank with a claim of R7 000.

(B) Withdrawals

If the account is in overdraft and a withdrawal is made from it a contract of loan by the bank to the customer comes into existence.

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(317) See 557-60 above.

(318) See 560-1 above.

In seeking to determine in what circumstances this contract should be validated it is necessary to *distinguish between* payment instructions given outside the scope of any overdraft facility granted by the bank prior to presentation of the *winding-up* application and payment instructions given within the scope of such a facility.

In the case of a payment instruction given outside the scope of any overdraft facility the bank is not obliged to honour the payment instruction, but if it elects to do so the resulting contract of loan should be validated unless it was not normal and arm's length or the bank knew or ought to have known that it was not in the interests of creditors, except that if the shareholders' interests would have taken precedence had application for validation been made in advance and the bank knew this and relied on it validation should not be refused on the ground that the bank knew that the loan was not in the interests of creditors.(319)

In the case of a payment instruction given within the scope of an overdraft facility the bank is obliged to honour the payment *instruction and the view will* be taken below(320) that the bank is not relieved of this obligation by reason merely of the fact that a winding-up application has *been presented* against the company: the bank must first give reasonable notice withdrawing the facility.(321) It follows that the bank should normally be

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(319) See 555-7 above.

(320) See 633-46 below.

(321) Even if the facility is repayable on demand the view is taken that the bank is obliged to continue honouring payment instructions given within the scope of the facility before its withdrawal and presented within a reasonable period after withdrawal, although the customer must immediately re-imburse the amount of each payment instruction as it is honoured.

entitled to validation of the contract of loan arising from any payment instruction given within the scope of an overdraft facility before expiry of the notice withdrawing the facility.[322] The question of whether the bank ought to give notice withdrawing the facility is also considered below[323] and the conclusion reached there is that the bank need only do so if it knows or has reason to suspect that improper payment instructions will be given.

In determining whether or not a loan is in the interests of creditors it is not only the terms and conditions of the contract of loan itself that are relevant but also the intended use to which the monies borrowed are to be put. On the other hand, no onus should be imposed on the bank to institute safeguards to ensure that withdrawals are only made in the ordinary course of the company's business or that preferential payments are not made to some creditors to the prejudice of other creditors or that withdrawals are only made as long as it is in the interests of creditors that the company's business should be continued.[323a]

The actual payment of the withdrawal is not a disposition and does not require validation.[324]

If the contract of loan is not validated the bank will be limited to such claims as it may have based on unjust enrichment.[325]

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(322) The bank may be denied validation if it was aware at the time of granting the facility that it was not in the interests of creditors despite the fact that the grant of the facility preceded presentation of the winding-up application - see 535 above.

(323) See 645-6 below.

(323a) See 586-8 above.

(324) See 375-91 above.

(325) See 629 below.

(C) Security

If the company furnishes security for its existing overdraft the security constitutes a preference to the bank and should not be validated. It will not avail the bank that it was unaware of the presentation of the winding-up application;(326) or that the security was given in the ordinary course of business,(327) or that the bank gave an extension of time for payment of its claim in consideration of the security,(328) or that the bank gave an increased overdraft facility in consideration of the security.(329)

If the security was established before presentation a new disposition nevertheless occurs as each debt is incurred and becomes secured by the security.(330) If the contract of loan giving rise to the debt is validated the disposition constituted by the debt's becoming secured by the security should likewise be validated by reason of the bank's reliance on the security in giving the credit concerned.(331) The position is similar where the security was established after presentation.

If not only existing property but also future property is furnished as security a new disposition occurs as each new item of

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(326) See 536-41 above.

(327) See 545-54 and 557-60 above.

(328) See 573-4 above.

(329) See 569-73 above. The security will be validated insofar as it applies to the increase in the facility - see 557-60 above.

(330) See 404-11 above.

(331) See 557-60 above.

property becomes subject to the security, even if this occurs automatically.(332) For example, if a company cedes to the bank all book debts from time to time owed to the company, a new disposition occurs as each new ceded debt comes into existence. Each such new disposition should be validated save to the extent it improves the bank's position.

Where security was furnished before presentation and after presentation different security is substituted, the new security should, it is considered, be validated by reason of the bank's reliance on the new security in releasing the old security, unless, and to the extent, it improves the bank's position.(333)

(iii) The bank's charges

Banks make charges for deposits to and withdrawals from customers' accounts. Moreover, because the customer has a discretion as to whether or not to incur any charge by making the withdrawal or deposit concerned, the date of the disposition in regard to each charge is the date the customer exercises this discretion by making the deposit or withdrawal.(334) It follows that it is necessary to consider whether the incurrence by the customer of the liability for the bank's charges should be validated. The question will, however, only be dealt with fairly briefly because of its limited practical significance.

The broad answer to the question is, it is thought, that if the transaction to which the charge relates is not avoided by s 341(2),

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(332) See 414-7 and 420 above.

(333) Cf Albion Reid (SA) (Pty) Ltd v Baron Holdings (Pty) Ltd (1973) 7 SASR 564 dealt with at 575-6 above; Re Omnico Ltd (1976) 1 ACLR 381(NSW).

(334) See 392-3 above.

either because it is not a disposition or because it is validated, the charge should be validated. This, however, calls for closer examination.

In the case of a deposit to a credit account the view has already been taken[335] that the deposit should be validated and the same is, it is considered, true for the same reasons of the bank's charges.

In the case of a deposit to an account in overdraft the position is more complex. The contract for payment of the bank's charges would no doubt be normal and arm's length and before prima facie the bank should be entitled to validation of its charges.[336] Moreover, inasmuch as the bank is obliged to accept the payment, knowledge on the part of the bank at the time of payment that the payment is not in the interests of creditors should not disentitle the bank to validation of its charges in that the relevant date of the bank's knowledge would be the date of the bank customer contract ie the date when it became obliged to accept deposits to the account.[337]

Where the deposit is validated - eg because the bank relies on it in permitting subsequent withdrawals[338] - it is no doubt correct that the bank's charge should also be validated. But what is the position if the deposit is not validated because it preferred the bank? The answer is, it is suggested, that if the deposit does not qualify for validation because it prefers the bank it would be anomalous if the bank could charge for collecting the preferential payment and validation should therefore normally be refused. The

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(335) See 604 above.

(336) See 555-7 above.

(337) Cf 607-8 above.

(338) See 606 above.

ground for such refusal is, it is thought, that the bank does not in fact render a service to the customer in accepting the preferential payment; accordingly, it would be inappropriate that it should be entitled to levy a charge as if it had rendered a service.(339)

A withdrawal from an account which is in credit does not require validation,(340) but the incurrence by the customer of liability for the bank's charge for the withdrawal does and it is thought that the incurrence of such liability should be validated on the ground that it is normal and arm's length.(341)

Where a withdrawal is made within the scope of an overdraft facility the bank will normally be entitled to validation of the contract of loan,(342) and it is thought that the bank's charges should be validated for the same reasons that the loan should be validated.(343)

Where a payment instruction is given outside the scope either of a credit or of an overdraft facility, the bank will in general nevertheless be entitled, if it honours the payment instruction, to validation of the resulting contract of loan on the ground that it is normal and arm's length,(344) and it is thought that the bank's charges should be validated for the same reason.

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(339) A contrary argument, which may prevail depending on the facts of the case in question, is that the customer may in fact have enjoyed the benefit of being able to deposit its money in the bank. For example, if the bank would have freely allowed the customer to withdraw the monies again the position is directly comparable to the position where a deposit is made to a credit account and validation may well be appropriate.

(340) See 375-91 above.

(341) See 555-7 above.

(342) See 607-8 above.

(343) Ibid.

(344) See 607 above.

If the customer's account was in credit, the set-off of the charges against the credit should be validated on the ground that the bank did not extend credit to the customer for the charges.(345)

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(345) See 557-60 above. The position is comparable to a purchase of goods for cash.

CHAPTER 12 - PROCEDURE TO OBTAIN A VALIDATION ORDER

Synopsis

Only the supreme court can validate a disposition. Proceedings for advance validation will generally be brought by the company and the appropriate procedure is ex parte motion proceedings. Ex post facto validation will generally be sought by the disponee and the appropriate procedure is either a trial action or motion proceedings depending on whether or not there is a material dispute of fact. The liquidator must be joined. Individual shareholders, directors and creditors do not have locus standi. The liquidator has locus standi even where the property sought to be recovered forms part of a creditor's security.

Where the liquidator seeks to recover a disposition, the onus is on the liquidator to prove the disposition and on the disponee to prove that it should be validated. The degree of proof required is such proof as creates a balance of probabilities in favour of the party who bears the onus of proof.

If a disponee succeeds in an application for validation he should normally be awarded his costs but the costs will not qualify as costs of 'maintaining, conserving, and realising' property within the meaning of s 89(1) of the Insolvency Act.

In an advance application the contract between the company and its legal representatives to pay the costs and the payment of the costs both also require validation.

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(1) The appropriate court

The appropriate court in which to seek a validation order under s 341(2) is the division of the supreme court within the area of jurisdiction of which the registered office or main place of business of the company is situate.(1)

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(1) Section 12(1) of the Companies Act.

(2) Action or application - joinder

There are no special rules of court or winding-up rules dealing with proceedings for validation and the question of the appropriate form of proceedings accordingly falls to be answered according to general principles and the general rules of court.

This may be contrasted with the position in, for example, England where proceedings pursuant to the English counterpart of s 341(2) are heard by a registrar in chambers on a summons requiring the person against whom an order is sought to attend the hearing.(2)

In seeking to determine the appropriate form of proceedings it is convenient to examine advance and ex post facto validation separately.

(a) Advance validation

Proceedings for advance validation are likely almost invariably to be brought by the company(3) and the appropriate form of proceedings is ex parte motion proceedings. The creditors do not have a sufficient interest for it to be necessary to join them. It is only necessary to join a person in proceedings if he has a direct material interest therein, ie 'an interest in the right which is the subject matter of the litigation and not merely a financial interest

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(2) Companies (Winding-up) Rules SI 1949 no 330, rules 2(1), 5(3), 7(1) and 8(2).

(3) For an exception see Re Pacific Coast Fisheries (Pty) Ltd (1980) 5 ACLR 354 (Qld).

which is only an indirect interest in such litigation',[4] and the creditors only have, it is thought, such an indirect interest. There is no reason to join the disponee.

(b) Ex post facto validation

Proceedings for ex post facto validation are likely invariably to be brought by the disponee, and obviously he will need to join the liquidator in the proceedings.[5] The question of whether the proceedings should be brought by way of trial action or motion proceedings depends upon whether or not there is a real dispute between the parties on any material question of fact.[6]

(3) Locus standi

In order to have locus standi to institute proceedings a person must have a direct material interest in the proceedings.[7] Clearly the company and the disponee have such an interest in validation proceedings. The question arises, however, as to whether locus standi is enjoyed by individual shareholders, directors and creditors.

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(4) Henri Viljoen (Pty) Ltd v Awerbuch Brothers 1953(2) SA 151(O) at 169H.

(5) Herbstein & Van Winsen Civil Practice 167 ff. It is not necessary to join the creditors - Krextile Holdings (Pty) Ltd v Widdows; Re Brush Fabrics (Pty) Ltd [1974] VR 689 at 691 (10-15).

(6) See eg Room Hire Co (Pty) Ltd v Jeppe Street Mansions (Pty) Ltd 1949(3) SA 1155(T) at 1161; Herbstein & Van Winsen op cit 60 ff.

(7) See eg Rescue Committee, Dutch Reformed Church v Martheze 1926 CPD 298 at 300; Constantia Landgoed (Edms) Bpk v Bethalrand (Edms) Bpk & Others 1976 (4) SA 1(T) at 5 C-D.

In Re Argentum Reductions (UK) Ltd[8] a shareholder applied for validation and in rejecting an objection to the applicant's locus standi Megarry J said:[9]

> 'To a shareholder ... it may be a matter of great concern, as closely affecting the value of his shares, that certain transactions should be saved from being invalidated. True, the shareholder as such will usually be no party to the transaction, and so it can be said that his interest in validating it is not direct but only indirect: yet an indirect interest may be of great value and importance. Why should a person with an interest to protect, even if it is indirect, be driven from the court when neither the Act nor the Rules give any indication that he should be excluded? Where the company is able to apply to the court but chooses not to do so, the question of the weight to be attached to an application made by a person with an indirect interest is another matter: I am here concerned only with the right to apply ....
>
> 'Accordingly, in my judgment a shareholder has a sufficient locus standi to make an application under s 227 for the validation of dispositions.'

A director was a joint applicant and Megary J continued:

> '... I need not decide whether Mr McAllister, who is merely a director, has a sufficient locus standi; indeed, very little was said about him in argument. As at present advised, I am not disposed to dismiss his claims to any locus standi as summarily as I think Mr Potts would. A director may have himself carried through the particular disposition in question, and if the company is deadlocked and can make no application the director might properly consider that he has a duty to the company to attempt to validate a disposition which the other party to it may be ready indeed to leave as having been struck down by the section. However, as I have said, I do not need to decide the point as to Mr McAllister, and I do not do so.'

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(8) [1976] 1 All ER 608 (Ch). See, too, Re Burton & Deakin Ltd [1977] 1 All ER 631 (Ch) at 636 d-e; L Crabb 'Bringing Actions in the Name of the Company' 1976 NLJ 1010 at 1011-12; Henochsberg Companies Supplement 115-16.

(9) At 611f - 612a.

The facts in the case were that the issued share capital of the company consisted of 95 shares of which 48 were held by Mrs McAllister and 47 by Mrs Jenkins. The directors of the company were the shareholders' husbands and the board was deadlocked. Mrs Jenkins then presented a petition for the winding-up of the company, with the result that Mr McAllister who in fact ran the business of the company could not pay its debts because of the provisions of the English counterpart of s 341(2). He and his wife therefore applied for an advance validation order to enable the business to be continued. The company was in fact solvent but such an application was necessary because the English counterpart of s 341(2), unlike s 341(2), is not limited to companies which are unable to pay their debts.

It is not entirely clear that the court would have reached the same conclusion had the company been unable to pay its debts but it is thought that it probably would have. However, whether our courts will follow this decision must be regarded as questionable. As Megarry J pointed out, a shareholder's interest is indirect only and the same is all the more true of a director's interest, and our law, as already pointed out, requires a direct interest.(10) The

(10) In fact the court should, with respect, have held that the director had locus standi not qua director but on behalf of the company. Although the director had not been formally appointed as managing director, he de facto ran the company and if his implied authority extended to making payments on behalf of the company, as was apparently the case, his authority would, it is thought, necessarily also have extended to applying to court on behalf of the company for the validation of those payments. Had the director's implied authority not extended to making payments, validation of the payments he proposed to make without authority would have been meaningless because the payments could in any event not have been made (unless the court had in mind that Mrs McAllister would use her voting rights to appoint another director to break the deadlock on the board or to manage the company in general meeting under the members' residual rights of management where the board is deadlocked (Barron v Potter [1914] 1 Ch 895)).

question of locus standi is closely linked to joinder and misjoinder. A person may only be joined in proceedings if he has a direct material interest in the proceedings and an indirect financial interest is insufficient.[11] If a party who does not have such an interest is joined there is a misjoinder.[12] The view has already been taken that the shareholders do not have such an interest, and it follows, it is considered, that they do not have locus standi to institute validation proceedings. The same applies to the individual directors and the individual creditors.

In Couve v J Pierre Couve Ltd (in liquidation) & Anor[13] it was argued that the liquidator had no locus standi because the property in question formed part of the security granted to a debenture holder and that the debenture holder was therefore the only party to have locus standi. The court rejected[14] this argument and it is thought that the position is the same under our law.

(4) Onus

Where an advance application is made for validation the onus will obviously vest in the applicant.[15] Similarly, where the

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(11) See eg Marais & Others v Pongola Sugar Milling Co & Others 1961(2) SA 699 (N) at 702F-G. See too 615-6 above.

(12) See eg Van der Lith v Alberts & Others 1944 TPD 17 at 22; Herbstein & Van Winsen Civil Practice 170.

(13) (1933) 49 CLR 486 (HC of A).

(14) At 488 and 496-7.

(15) See eg Re Burton & Deakin Ltd [1977] 1 All ER 631 (Ch) at 635h-636a; Re Pacific Coast Fisheries (Pty) Ltd (1980) 5 ACLR 354 (Qld) at 356.

disponee brings proceedings for ex post facto validation he will bear the onus.[16] Where the liquidator brings proceedings to recover a disposition he will bear the onus of proving the disposition[17] but the question arises, if the disponee opposes the proceedings on the ground that the disposition should be validated, of who bears the onus in regard to validation. The answer is, it is considered, that the defence is in the nature of a special defence and that therefore the disponee bears the onus:

> 'The first principle in regard to the burden of proof is thus stated in the Corpus Juris: "Semper necessitas probandi incumbit illi qui agit" (D.22.3.21). If one person claims something from another in a Court of Law, then he has to satisfy the Court that he is entitled to it. But there is a second principle which must always be read with it: "Agere etiam is videtur, qui exceptione utitur: nam reus in exceptione actor est" (D.44.1.1). (Exceptio does not mean, of course, an exception in the sense in which the term is now used in our practice.) Where the person against whom the claim is made is not content with a mere denial of that claim, but sets up a special defence, then he is regarded quoad that defence, as being the claimant: for his defence to be upheld he must satisfy the Court that he is entitled to succeed on it'

(per Davis AJA in Pillay v Krishna & Anor[18]).

This was the view taken in Re Atlas Truck Service (Pty) Ltd[19] in relation to the Australian counterpart of s 341(2). The

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(16) See eg Re Selmar (Pty) Ltd [1978] VR 531 at 534(5); J Sen Gupta Private Ltd AIR 1962 Cal 405 at 406(5).

(17) In re John Daly & Co Ltd (1886) 19 LR (Ireland) 83 at 92. Cf too In re London Suburban Bank (1872) 15 Eq 274 at 278.

(18) *1946 AD 946 at 951-2. See too CWH Schmidt* Bewysreg 2nd ed (Durban 1982) 38 ff.

(19) (1974) 4 ACTR 19 at 23(35).

liquidator applied for a declaration that 2 payments made by the company were void and the court held that the onus of making out a case for the favourable exercise of the court's discretion to validate was upon the respondent. On the other hand, in similar circumstances in In re Clifton Place Garage Ltd[20] Sachs LJ said that in the 'special circumstances' of that case the onus lay on the liquidator. However, Sachs LJ did not indicate what special circumstances he was referring to and it is not clear what circumstances he may have had in mind.[21]

(5) Degree of proof

The degree of proof required is, it is considered, the ordinary degree in civil matters, namely proof creating a balance of probabilities in favour of the party bearing the onus of proof.[22] What evidence will be required to create such a balance of probabilities will depend on the circumstances:

> 'Where the application relates to a specific transaction this may be susceptible of positive proof. In a case of completion of a contract or project the proof may perhaps be less positive but nevertheless be cogent enough to satisfy the court that in the interests of the creditors the company should be enabled to proceed, or at any rate that proceeding in the manner proposed would not prejudice them in any respect. The desirability of the company being enabled to carry on its business generally is likely to be more speculative and will be likely to depend on whether a sale of the business as a going concern will probably be more beneficial than a break-up realisation of the company's assets'

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(20) [1970] Ch 477 (CA) at 492G.

(21) See 597-600 above.

(22) See eg Miller v Minister of Pensions [1947] 2 All ER 372 (KB) at 374A-B; Ocean Accident and Guarantee Corporation Ltd v Koch 1963 (4) SA 147 (A) at 157D; Schmidt Bewysreg 81 ff.

(per Buckley LJ in Re Gray's Inn Construction Co Ltd[23]).

(6) Costs

Where the company seeks validation in advance it will have to bear the costs of the proceedings. Moreover, as both the contract to pay the costs and the payment of the costs constitute dispositions they, too, will require validation.

Where the disponee successfully seeks validation ex post facto he should normally be awarded his costs:

> '... I see no reason why an applicant ... ought to be obliged to come to the Court at his own cost. What Mr. Rowley did was for the benefit of the company and not for his own benefit. It follows that the costs of the successful application may well be regarded as mortgagee's costs, and I therefore direct that he add them to his security. The costs of the liquidator will be included in his costs of the liquidation'

(per Romer J in In re Park Ward and Company Ltd[24]). The costs will be preferent as part of the administration costs.[25]

Whether or not the costs incurred by the holder of security given by the company in seeking validation of the security will constitute costs of 'maintaining, conserving, and realising' the property within the meaning of s 89(1) of the Insolvency Act as

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(23) [1980] 1 All ER 814(CA) at 820 b-c.

(24) [1926] Ch 828 at 832. See, too, Re Steane's (Bournemouth) Ltd [1950] 1 All ER 21(Ch) at 25 B; Re Selmar (Pty) Ltd [1978] VR 531 at 535 but see Re J Sen Gupta Private Ltd AIR 1962 Cal 405 at 409(14) in which the court refused the applicant costs without explanation.

(25) Section 97(2)(c) of the Insolvency Act read with s 342(1) of the Companies Act.

applied to companies by s 342(1) of the Companies Act is less clear. In Re TMV (Excavations) (Pty) Ltd[26] the court held that such costs are not costs of 'preserving, realising or getting in' the property within the meaning of the Australian counterpart of s 89(1), and it is thought that this is also true of s 89(1) of the Insolvency Act. The costs of seeking validation are incurred to 'maintain' or 'preserve' the security, not the property.

It does not, of course, follow that the disponee will always be awarded his costs. For example, in Tulsidas v Industrial Bank of Western India[27] the court a quo had refused the disponee costs despite the fact that it granted a validation order, on the grounds that the disponee had put obstacles in the liquidator's way by delaying in answering his demand and by not stating the grounds on which the disponee contended it was entitled to a validation order and that the disponee had caused unnecessary procedural delays. The appeal court reversed the court a quo's decision in regard to validation but expressly approved this approach to the question of costs.

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(26) (1930) 4 ACLR 857 (NSW) at 860.

(27) AIR 1931 Bombay 2 at 16-17. See too In re Wiltshire Iron Company Ex p Pearson (1868) 3 Ch App 443 at 452 in which the court also refused the applicant costs, apparently because he failed to put all the relevant information before the court at the first hearing.

CHAPTER 13 - CONSEQUENCES OF NON-VALIDATION

Synopsis

Section 341(2) does not specify the consequences of non-validation and ss 32 and 33 of the Insolvency Act do not apply to the section. The consequences of non-validation must therefore be determined according to general principles.

The property disposed of under a disposition avoided by the section cannot be recovered from a bona fide third party. The avoidance of a contract does not relieve a surety of liability. The avoidance of the discharge of an obligation reinstates both a surety's liability and any security released pursuant to the discharge, although it may be necessary for the security to be perfected again eg it may be necessary for a pledgee to regain possession of the pledged goods. If a contract of loan is avoided as a disposition by the borrower the lender will be restricted to such claims as the lender may have based on unjust enrichment. The liquidator can claim mora interest on a void disposition after expiry of a reasonable period after the demand for the return of the disposition. The directors may be personally liable for any loss suffered by the company if they were guilty of a breach of their fiduciary duty or of their duty of care and skill in causing a company to make a disposition which is avoided by the section.

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Section 341(2) is silent on the consequences of non-validation beyond stating that the disposition will be void and it is therefore necessary to have regard to the general principles of the law in seeking to determine what these consequences are:

> 'It must be remembered that the invalidation of a disposition of the company's property and the recovery of the property disposed of, are two logically distinct matters. Section 227 of the 1948 Act says nothing about recovery .... What is the appropriate remedy in respect of the invalidated disposition is a matter not regulated by the Act and that has to be determined by the general law'

(per Oliver J in Re J Leslie Engineers Co Ltd[1]).

In dealing with the general principles of the law governing the position it is intended to highlight certain issues only.

(1) Section 32 of the Insolvency Act

In Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor[2] the court considered whether s 32 of the Insolvency Act applies to s 341(2) and concluded that it does not:

'In this regard I think it is apposite to point out that the provisions of s 339 of the Companies Act - which, as already stated, make the provisions of the law relating to insolvency, insofar as they are applicable, of application, mutatis mutandis, in respect of any matter not specially provided for in the Companies Act - do not envisage that the procedure and the orders provided for in s 32 of the Insolvency Act are applicable to a claim based on the provisions of s 341 of the Companies Act. Section 32(3) of the Insolvency Act provides that the Court, "When it sets aside a disposition of property under" s 26, 29, 30 or 31 of the Insolvency Act,

> "shall declare the trustee entitled to recover any property alienated under the said disposition or in default of such property the value thereof at the date of the disposition or at the date on which the disposition is set aside, whichever is the higher."

'Since the disposition which is void by virtue of the facts postulated in s 341 of the Companies Act is not a disposition which is similar or akin to any one of the impeachable transactions and dispositions for which s 26, 29, 30 or 31 (or, for that matter, ss 33 and 34) of the Insolvency Act make specific provision, s 32 of the Insolvency Act cannot be invoked to supply the procedure for a claim based on s 341 of the Companies Act. Section 341 stands alone in this regard.'

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(1) [1976] 2 All ER 85 (Ch) at 90 b-c. See, too, Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor 1980 (4) SA 669 (SWA) at 680H.

(2) Supra at 681 E-H.

This conclusion is no doubt correct, but it is unfortunate because the desirability of a provision such as s 32, and for that matter s 33 as well, is clear in order to clarify questions such as who may take action for recovery, what may be recovered, from whom it may be recovered and what the position is of the person from whom the recovery is made if he has in the meantime acted in good faith to his prejudice in reliance on the disposition eg if security has been released in reliance on a payment which is avoided.(3)

(2) Recovery from bona fide third party

The question of whether the property disposed of by the company can be recovered from a third party who has in good faith acquired it from the disponee has already been considered above(4) and it suffices to note here that the conclusion reached there is that the property cannot be recovered from the third party because the disposition is voidable only and not void ab initio.(5)

If this view is incorrect, a claim would lie against a third party but only if he had not already disposed of the property again in good faith.(6)

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(3) Sections 32 and 33 could themselves be usefully amplified to deal with questions such as the fruits of the property, improvements to the property, destruction or depreciation in the value of the property without fault on the disponee's part and release of sureties.

(4) See 312-9 above.

(5) In regard to the position in English law see Pennington Company Law 723.

(6) See eg Berkowitz's Trustee v Brewer & Segal 1908 TS 1036 at 1041.

(3) Effect of avoidance on suretyships

If a contract is avoided by s 341(2) is a surety's liability for the company's obligations under the avoided contract extinguished?

A similar question arose in Linden Duplex (Pty) Ltd v Harrowsmith.(7) The question in issue was whether a surety can raise the defence that the principal debt is liable to be set aside as a disposition without value in terms of s 26 of the Insolvency Act. The court referred to the general rule that a surety may avail himself of any defence which is open to the principal debtor except where the defence arises not upon the obligation itself but from some personal privilege granted only to the debtor, and after pointing out that the remedy provided by s 26 was 'plainly not designed to benefit the principal debtor' the court concluded that it was 'a remedy arising out of the obligation itself ... [and] not a personal privilege granted to the principal debtor' and hence was available to the surety.

This decision has, however, been convincingly criticised by a number of writers. Whiting(8) points out that the court overlooked that the remedy provided by s 26 is not available to the principal debtor but is on the contrary available only to the principal debtor's trustee. Moreover, even if the trustee had invoked the section this would not have availed the surety because the setting aside of the disposition does not affect the validity of the underlying obligation, 'it merely cannot be enforced against the estate in competition with the claims of creditors'.(9)

(7) 1978(1) SA 371(W).

(8) R C Whiting 'A Novel Defence for a Surety' (1978) 95 SALJ 25.

(9) See, too, C F Forsyth Caney's The Law of Suretyship in South Africa 3rd ed (Cape Town 1982) at 103-4; C Lewis 'Personal Defences Available to the Principal Debtor Alone' 1978 Annual Survey 217-18.

With respect, these criticisms are well-founded and the court should have held that the surety could not raise the impeachability of the disposition as a defence. The same is, it is considered, true of a suretyship for an obligation which is avoided by s 341(2). The view has already been taken[10] that only the liquidator can invoke s 341(2) and the avoidance of the obligation by the section is therefore not available as a defence either to the principal debtor or to the surety. Moreover, even if the liquidator does invoke the section the avoidance of the obligation should, it is believed, also be interpreted as merely rendering the obligation *unenforceable*, not as entirely extinguishing it. The contrary interpretation would have the anomalous result that s 341(2) would have the effect of discharging sureties *despite the fact that this* is obviously not its object and that suretyships are generally intended to protect the creditor whatever the reason for the principal debtor's non-performance.[11]

A *second question* arises in regard to the effect of s 341(2) on suretyships: If the discharge by the principal debtor of an obligation is avoided what is *the effect of such* avoidance on the position of a surety whose liability was extinguished by the discharge of the obligation? The answer is, it is thought, that the surety's liability is re-instated.[12]

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(10) See 312-9 above.

(11) Cf, too, In re London Chartered Bank of Australia [1893] 3 Ch 540 at 548-7 *and* Dane v The Mortgage Insurance Corporation Ltd [1894] 1 QB 54(CA) at 62-4 in which it was held that where a company is released from its debt under a scheme of arrangement a surety is not released.

(12) Wessels Contract # 4224; Petty v Cooke (1871) 6 QBD 790. But see Commercial Bank of Australia v Carruthers (1964) 6 FLR 247 (NSW) at 250-1, 253 where the court reached the opposite conclusion in regard to the *setting aside of a payment* under

(Footnote continued on next page)

(4) Effect of avoidance on release of security

If security was released by the disponee on discharge by the company of its obligations what is the disponee's position if the disposition is thereafter avoided by s 341(2)? The answer is, it is considered, that as in the case of a surety the security is re-instated, provided that where the requirements for the validity of the security are no longer met - eg if the creditor released pledged goods from his possession on discharge of the obligations - it will be necessary for the creditor to reperfect the security. If it is not possible for the creditor to do so this would be a strong factor in favour of validation of the discharge of the company's obligations.(13)

(5) Recovery of monies advanced if contract of loan is avoided

If a contract of loan to the company is avoided, the lender will be unable to prove a claim in contract for the monies advanced and will be limited to such claims as he may have based on unjust enrichment.

(Footnote continued from previous page)
the Australian bankrupty legislation. The court distinguished Petty's case on the ground that the English legislation required an intention to prefer whereas the Australian Act required only that the effect be a preference, but it is difficult to see what bearing this has on the question. In arriving at the conclusion that the effect of the Australian legislation was not to revive the surety's liability the court relied on the fact that a preference was only declared to be void 'as against the trustee', but again it is difficult to see the relevance of this.

(13) Cf 557-60 above.

(6) Mora interest

The liquidator can claim mora interest on a void disposition from expiry of a reasonable period after the demand for the return of the disposition.[14]

(7) Personal liability of directors

In Re Neath Harbour Smelting and Rolling Works[15] Chitty J said:

> The effect of [the English counterpart of s 341(2)] is this, that unless the court sanctions any of those payments, they are void .... The language of sect. 165 is, "Where in the course of the winding-up it appears that any past or present director has misapplied or become accountable for any moneys of the company", then he may be proceeded (sic) against. So the result is, as the combined effect of the two sections, that the directors are prima facie liable and responsible for the moneys of the company in respect of the void payments they have made.

Section 423 of the 1973 Act corresponds to s 165 of the English Act of 1862, but it should be noted that it has been held[16] that s 423 does not create a new cause of action: it merely provides a summary remedy for the enforcement of existing causes of action recognised by the law. The directors will therefore only be

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(14) Herrigel NO v Bon Roads Construction Co (Pty) Ltd & Anor 1980 (4) SA 669 (SWA) at 682D - 686B.

(15) (1887) 56 LT 727 (Ch) at 729. See, too, Tulsidas v Industrial Bank of Western India AIR 1931 Bombay 2 at 20; Anhadra Bank Ltd v Narayana Rao AIR 1955 Madras 247 at 249; The First National Bank Ltd v Om Parkash & Others AIR 1962 Punjab 433 at 438(29)-440(40). Cf Re Steane's (Bournemouth) Ltd [1950] 1 All ER 21 (Ch) at 24H; Re J Leslie Engineers Co Ltd [1976] 2 All ER 85 (Ch) at 90h.

(16) Lipschitz & Schwartz NNO v Markowitz 1976 (3) SA 772(W).

personally liable if there was a breach of their fiduciary duty or of their duty of care and skill or another recognised ground for holding the directors personally liable.[17]

It is not clear whether a disponee who is obliged to restore the company's property is entitled to an indemnity from the directors *eg on* the ground that the directors have breached their implied warranty of authority.

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(17) See generally Cilliers & Benade Company Law # 22.15 ff.

CHAPTER 14 - INTERDICTING PRESENTATION

Synopsis

The court may interdict presentation of a winding-up application.

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If a company is aware that an unfounded winding-up application is about to be presented against it can it seek an interdict to prevent presentation with a view to *avoiding the harm* that *may* flow from presentation? Such interdicts have been granted both in England[1] and in Australia[2] and it is considered that there *is no reason why they should not* be granted in this country.[3]

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(1) See eg Charles Forte Investments Ltd v Amanda [1964] Ch 240 (CA).

(2) See eg F J Reddacliffe & Associates (Pty) Ltd v Arc *Engineering (Pty) Ltd* (1978) 3 ACLR 426(NSW).

(3) Cf Gatx-Fuller v Shepherd and Shepherd Inc 1984(3) SA 48(W) in which presentation was interdicted where *the intending* applicant's claim was disputed.

CHAPTER 15 - MAY BANK REFUSE TO HONOUR PAYMENT INSTRUCTIONS AFTER PRESENTATION?

Synopsis

In England and Australia it is customary for banks to freeze a customer's account as soon as a winding-up petition is presented against the customer, and this gives rise to the question of whether the banks of this country may do likewise or whether such action would give rise to a claim for damages for wrongful dishonour.

In this country the question of entirely freezing the account does not arise because the position in regard to cheques is governed by s 73(c) of the Bills of Exchange Act which protects the payment of cheques until the bank receives notice of the grant of a winding-up order. The problem is therefore limited to payment instructions other than cheques.

If the account is in credit no difficulty arises. Payments to the company are not dispositions by the company of its property and payments to third parties in accordance with the company's instructions must be analysed into 2 payments: a payment by the bank to the company which is not a disposition by the company and a payment by the company to the third party which is such a disposition, but which is recoverable from the third party not the bank.

The problem arises where the account is in overdraft and a payment instruction is given within the scope of an overdraft facility. Even if an overdraft is repayable on demand, the bank is obliged to honour payment instructions issued before withdrawal of the overdraft facility and which are presented for payment, or otherwise become payable, within a reasonable period after withdrawal of the overdraft facility, and failure to honour such payment instructions is a breach of contract. On the other hand, if the payment instructions are honoured by the bank and the customer is thereafter placed in winding-up the contracts of loan arising from the payment instructions and any security held by the bank for its claim for repayment will be avoided by s 341(2) unless the court otherwise orders.

Despite this risk the bank is not relieved of its contractual duty to honour the customer's payment instructions. Section 341(2) has no application until a winding-up order is granted and a term relieving the bank of liability cannot be implied in the bank customer contract nor is there a trade usage to this effect. The bank's dilemma is, however, more apparent than real because if the bank is obliged to honour the payment instruction the resultant contract of loan and the security for the bank's claim for repayment of the loan should be validated by the court.

There is no onus on a bank to withdraw an overdraft facility as long as it does not know, or have reason to suspect, that payment instructions are being given, or are likely to be given, that would not qualify for validation, but if at any time it becomes aware, or has reason to suspect, that such payment instructions are being given or are likely to be given it ought to withdraw the facility and failure to do so will weigh against it in subsequent validation proceedings.

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If a bank learns that a winding-up application has been presented against a customer, may the bank refuse to honour payment instructions given by the customer, in view of the risk it may run pursuant to s 341(2) if it honours the payment instructions?

In both England[1] and Australia[2] it is generally the policy of the banks to refuse to honour a customer's payment instructions as soon as the bank learns of the presentation of a winding-up petition against the customer. In Re J Leslie Engineers Co Ltd,[3] in fact, the court went so far as to say:

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(1) See eg In re Clifton Place Garage Ltd [1970] Ch 477(CA) at 494B; Re Argentum Reductions (UK) Ltd [1975] 1 All ER 608 (Ch) at 610f. Cf 238-40 above.

(2) See eg Re Mal Bower's Macquarie Electrical Centre (Pty) Ltd [1974] 1 NSWLR 254 at 257E; McPherson Liquidation 143.

(3) [1976] 2 All ER 85 (Ch) at 87d and 91g-h.

'Although, as I have said, the petition was presented and advertised in September, both these cheques were, rather surprisingly, honoured by the bank, but I am not concerned here with any claims against the bank to which this fact may have given rise ....

'In the instant case, the liquidator, for reasons which have not been explained, has not sought to proceed either against Mr Hadrys, who was the person directly responsible, nor against the bank without whose co-operation (procured, no doubt, in ignorance of the petition) the payment could not have been made.'

But the question may be asked whether the bank is entitled to refuse to honour the customer's payment instructions. In the ordinary course this would give rise to a claim for damages for wrongful dishonour if the payment instructions are drawn within the scope of a credit in the account or an overdraft facility granted by the bank,(4) and the issue therefore is whether s 341(2) alters the position. This question arose in relation to the English counterpart of s 341(2) in D B Evans (Bilston) Ltd v Barclays Bank Ltd.(5) Paget(6) summarises the facts and outcome of the case as follows:

'Section 227 came before the Court of Appeal in somewhat unusual circumstances in D. B. Evans (Bilston) Ltd v Barclays Bank Ltd. On 16 January 1961 an application was made under s. 206 for a scheme of arrangement; the same day a creditor's petition for winding-up was presented. The court adjourned the winding-up proceedings pending the hearing of the s. 206 application. The defendant bank informed the plaintiffs that they were at liberty to draw certain of their balances but that certain others would be frozen, as would be any moneys paid in, while the winding-up petition remained on the file. Thus the plaintiffs were prevented from using the cash they received in the ordinary course of business and they sued the bank for breach of

(4) Freeman v Standard Bank of South Africa Ltd 1905 TH 26 at 30; Trust Bank of Africa Ltd v Marques 1960(2) SA 796(T) at 798B-C; Cowen Negotiable Instruments 394-415.

(5) (1961) Legal Decisions Affecting Bankers 283 (CA).

(6) Banking 247.

> contract, claiming an injunction restraining the bank from refusing to honour their cheques to the extent of their credit balance. The injunction was refused and the plaintiffs appealed, the court hearing the appeal as a matter of urgency. The defendant bank argued that if they collected the plaintiff's cheques and paid out to the company, they would be liable to account to a liquidator because, under s. 227, this would be a void disposition of the company's property. By arrangement between the parties and with the consent of the court, an order was made whereby the plaintiffs should pay their cheques into the company's account and that the defendants would honour cheques drawn against the balance providing: (i) that the cheques were drawn to 'cash' or to the order of the plaintiffs and (ii) were certified by a director or a senior partner of the company's solicitors or accountants as being necessary for the purposes of the business and for the benefit of the company or its creditors.'(7)

Paget(8) nevertheless concludes that 'no payments from [the company's bank account] should be permitted unless the court exercises its discretion and validates otherwise invalid dispositions'.

Chorley,(9) on the other hand, reaches the opposite conclusion:

> 'In the case of a compulsory order, the winding up commences at the time when the petition to the court to make the order is filed. As, however, the business of the company must be carried on until an order is made and a liquidator appointed, the authority of the directors must be regarded as continuing until that date. It would appear, therefore, not only that the bank is justified in paying cheques and generally in continuing business during this period, but that it ought to do so.'

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(7) See too F R Ryder 'Payment of cheques after presentation of *petition to wind up*' 1980 JBL 189.

(8) Banking 63. See also 247. Cf, too, DAL Smout Chalmers on Bills of Exchange 13th ed (London 1964) 255 where the same view is taken in relation to a petition for bankruptcy.

(9) Lord Chorley Law of Banking 6th ed (London 1974) 367.

Reeday[10] takes yet another view:

> 'When a bank learns that a winding up petition has been presented against a company customer but has not yet been heard by the Court, it should pay only cheques presented by the company for cash over the counter, e.g. wages cheques, any other cheques being returned marked "Winding up petition presented".'[11]

Halsbury[12] takes the same view as Reeday.

In seeking to determine whether a bank may refuse to honour a customer's payment instructions once a winding-up application has been presented *against the customer* it is necessary to have regard to a number of considerations.

The view has already been taken[13] that s 341(2) does not affect a bank's duty and authority to honour a customer's cheques inasmuch as the position in regard to cheques is governed by s 73(c) of the Bills of Exchange Act; accordingly, the question of whether a bank may decline to honour a customer's payment instructions after presentation of a *winding-up application against* the customer only arises in relation to payment instructions other than cheques. The English, Australian and Indian Bills of Exchange Acts, on the other hand, contain no counterpart of s 73(c), and their counterparts of s 341(2) accordingly also apply to cheques.

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(10) T G Reeday The Law Relating to Banking 4th ed (London 1980) 158.

(11) This approach accords with the English decisions that payment of a debt to a company is *not a disposition* of the company's property whereas payment to a third party in accordance with the company's instructions is such a disposition and is recoverable from the payer - see 375-91 above.

(12) Halsbury vol 3 'Banking' # 64(5). See too P J M Fidler Sheldon and Fidler's Practice and Law of Banking 11th ed (London 1982) 649, 662-3.

(13) See 161ff above.

The view has also already been taken[14] that payments made by a bank pursuant to a customer's instructions are not recoverable from the bank under s 341(2), whether made to the customer itself or to third parties in accordance with the customer's instructions. Payment to the customer itself is not a disposition by the customer of its property and payment to a third party in accordance with the customer's instructions must be analysed into 2 payments: a payment by the bank to the customer, which is not a disposition by the company of its property, and a payment by the customer to the third party, which is such a disposition but which is recoverable from the third party not the bank.[15] It follows that if the customer's account is in credit the bank is in no jeopardy arising out of s 341(2) and there is no need for the bank to refuse to honour the customer's payment instructions.[16]

The difficulty arises where the customer's account is in overdraft. In this country, unlike in England, Australia and India, the conclusion of a contract for a payment is a disposition within the meaning of s 341(2) and therefore the contract of loan which arises if a payment instruction is honoured at a time when the customer's account is in overdraft is itself a disposition.[17] It

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(14) See 375-91 above.

(15) This is consistent with the Australian decision in Re Mal Bower's Macquarie Electrical Centre (Pty) Ltd [1974] 1 NSWLR 254, but inconsistent with the English decision in Re Gray's Inn Construction Co Ltd [1980] 1 All ER 814 (CA) - see further 381-91 above.

(16) Even if the credit arose from deposits made after presentation the position is the same. True, the deposits would be void dispositions but the payments made pursuant to the customer's payment instructions would, it is thought, nevertheless constitute payments on account of the bank's liability to repay the void deposits.

(17) See 396-7 above.

follows that unless this contract is validated the bank cannot claim under the contract either for repayment of the monies paid out by it or for the agreed interest thereon and that the bank is limited to such claims as it may have based on unjust enrichment. Moreover, whatever claims the bank may have are not secured in the absence of validation by any security the bank may hold from the customer.[18] The bank may therefore be expected to wish to avoid the risk of having to apply for validation by declining to honour the customer's payment instructions. But is it entitled to do so?

This question only arises if the payment instructions are given within the scope of an overdraft facility because if the instructions are not given within the scope of such a facility the bank is under no duty to honour them.[19] If the bank is under a duty to honour the payment instructions 2 further questions arise: What is the general rule relating to the termination by a bank of its duty to honour a customer's payment instructions drawn within the scope of an overdraft facility, and to what extent, if any, is the general rule altered by s 341(2)?

Where the customer's account is in credit the bank may only terminate its duty to honour the customer's cheques and other payment instructions by terminating the bank customer contract, but where the customer's account is in overdraft and the bank has granted an overdraft facility the bank may terminate its duty either by terminating the bank customer contract or by withdrawing the overdraft facility. Although the bank is only in jeopardy pursuant to s 341(2) if the account is in overdraft, it is convenient to first examine the position regarding termination by the bank of the bank customer contract where the customer's account is in credit.

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(18) See 399-421 above.

(19) See 23 above.

If the customer's account is in credit it is well-recognised that if the bank wishes to terminate the bank customer contract it must, in the absence of agreement to the contrary, give reasonable notice of termination:

> 'Normally a bank is not entitled to close a customer's account without due notice. This is at least mainly for the protection of outstanding cheques'

(per Lord Kilbrandon in National Westminister Bank Ltd v Halesowen Presswork and Assemblies Ltd[20]). It is suggested, however, that it is necessary to distinguish 2 separate periods: firstly a reasonable period for the customer to make alternative banking arrangements and secondly a reasonable period thereafter for cheques issued prior to the expiry of the first period to be presented. During the first period the bank would be obliged to permit the customer to continue to operate on the account in all respects but during the second period the bank would only be obliged to continue to honour cheques issued to third parties prior to the expiry of the first period.

If the customer's account is in overdraft reasonable notice of termination of the bank customer contract would similarly be necessary to enable the customer to make alternative arrangements. On the other hand, no period of notice is, it is thought, necessary to withdraw an overdraft facility in the absence of agreement to the contrary: unless the parties have agreed otherwise overdrafts are repayable on demand without any period of notice,[21] and it logically follows, it is suggested, that the overdraft facility is similarly subject to withdrawal without any period of notice. On the other hand it does not necessarily follow that the withdrawal of the

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(20) [1972] 1 All ER 641(HL) at 662f-g. See too Joachimson v Swiss Bank Corporation [1921] 3 KB 110 (CA) at 127; Malan Bills of Exchange # 328.

(21) Willis Banking 141; Paget Banking 115; PJ Cresswell et alii Encyclopaedia of Banking Law (London August 1984) ## C181-3.

facility would relieve the bank of the obligation to continue to honour cheques issued to third parties prior to receipt by the customer of notice withdrawing the facility, and it is considered that the bank is not relieved of this obligation:

> 'It is not necessary to consider what the rights of the bank were with regard to their debtors when they had agreed to an overdraft. The transaction is of course of the commonest. It may be that an overdraft does not prevent the bank who have agreed to give it from at any time giving notice that it is no longer to continue, and that they must be paid their money. This I think at least it does; if they have agreed to give an overdraft they cannot refuse to honour cheques or drafts, within the limit of that overdraft, which have been drawn and put in circulation before any notice to the person to whom they have agreed to give the overdraft that the limit is to be withdrawn. That effect I think it has in point of law....'

(per Lord Herschell LC in Rouse v The Bradford Banking Company Ltd[22]). This is not inconsistent with the overdraft's being repayable on demand: if the overdraft is repayable on demand and demand has been made the customer will simply be obliged to repay the amount of each cheque as it is honoured by the bank.

There is no need for the bank's continuing obligation to honour the customer's cheques to apply to cheques drawn by the customer in its own favour and even if the bank's obligation did apply to such cheques the obligation would be extinguished by set-off against the customer's reciprocal obligation to immediately repay the amount payable.

In the case of payment instructions other than cheques the position is, it is thought, clearly similar where the payment instruction is issued to a third party, as in the case of a debit

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(22) [1894] AC 586 (HLE) at 595-6. See too Williams and Glyn's Bank Ltd v Barnes [1981] Com LR 205(QB) at 209-10(7); Volkskas Bpk v Van Aswegen 1961(1) SA 493(A) at 495G-496A; J Milnes Holden The Law and Practice of Banking 3rd ed (London 1982) vol 1 p 89; Malan Bills of Exchange p 328.

order. Where the payment instruction is not issued to a third party but is given to the bank direct, as in the case of a stop order, the position is less clear but again it is thought that the position is similar. True, the customer's reputation is not as directly at risk where the payment instruction is not presented by the payee for payment; however, the customer may nevertheless stand to suffer serious prejudice if the payment is not made - eg a valuable contract may lapse if payment is not made - and the customer may need time to make alternative arrangements.

This is the general rule but does s 341(2) alter the position?

It has already been pointed out[23] that s 341(2) has no application until a winding-up order is granted; prima facie, therefore, it would not relieve a bank of its contractual obligations before the grant of the order. It is thought, moreover, that the scheme of the winding-up provisions of the Act confirms this prima facie conclusion. The purpose of a winding-up application is to determine whether or not the company should be placed in winding-up; accordingly, a winding-up order may or may not ensue. It follows, it is thought, that it would be anomalous if the Act were to be interpreted as relieving debtors of their obligations to a company as soon as a winding-up application is presented even though no winding-up order may ensue.[24] Such an interpretation would have the result that the mere presentation of a winding-up application would be likely to cause serious harm to the company, whether well-founded or not.

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(23) See 255-6 above.

(24) But cf In re Bostels Ltd [1968] Ch 346 at 352 E-G and Re Nickel Mines Ltd (1978) 3 ACLR 686 (NSW) at 688 in which it was said that if a winding-up petition has been presented against a company the provisions of the English and Australian counterparts of s 341(2) respectively entitle the petitioning creditor to refuse to accept payment of his claimm despite the fact that no order has been granted.

There is, it is considered, also no common law principle which would relieve the bank of its contractual obligations. It would not seem possible to prove an implied term to this effect. Had the parties been asked at the time of conclusion of the bank customer contract whether the bank would be entitled to refuse to honour payment instructions on presentation of a winding-up application against the company, whether well-founded or not, it may be doubted whether the customer would have agreed.[25] It is, moreover, understood[26] that the banks in this country do not have a uniform, invariable practice of refusing to honour a company's payment instructions as soon as the bank learns that a winding-up application has been presented against the company and it would therefore likewise not be possible to establish a trade usage to this effect.[27]

It may be noted that Paget[28] states:

> 'The rights of the banker to decline unusual risks, clearly recognised since the Macmillan case, is not confined to those arising directly from ambiguity of the mandate whether in the framing or transmitting of it. It is a fair reading of the contractual obligation that not only shall the customer not impose, but the banker need not undertake, exceptional risks.'

Despite the wide phraseology, it may be doubted whether Paget intended to convey that a bank has a general right to decline any unusual risk. Certainly, Macmillan's case[29] is no authority for

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(25) See generally 76-91 above on implied terms.

(26) From officials of the banks.

(27) See eg Tropic Plastic and Packaging Industry v Standard Bank of SA Ltd 1969(4) SA 108 (D&CLD) at 119H-120A; Wille & Millin Mercantile Law 28.

(28) Banking 231.

(29) London Joint Stock Bank Ltd v Macmillan & Arthur [1918] AC 777 (HLE).

such a general proposition. The court expressly limited[30] the rule laid down in that case to negligence in the transaction itself. And the example given by Paget of an Arabic indorsement entitling the bank to defer paying while it ascertains the meaning of the indorsement is itself of fairly narrow compass. It is doubted therefore whether Paget intended his statement to extend as far as conveying that a bank would be entitled to decline to accept a risk such as the risk inherent in the honouring of a customer's payment instructions after presentation of a winding-up application against the customer, and if he did in fact intend to convey this its validity must, it is thought, be doubted in the absence of authority.

The fact that s 341(2) does not relieve the bank of its duty to honour the customer's payment instructions does not necessarily mean that it is entirely irrelevant to the question under consideration; on the contrary it is considered that it is a factor to which the court may properly have regard in determining the length of the period during which the bank is required to continue to honour payment instructions issued prior to the withdrawal of the overdraft facility. Where s 341(2) has no application the only relevant factor is likely to be what period is reasonable for third parties to present payment instructions issued prior to withdrawal of the overdraft facility, but where s 341(2) applies the court can, it is suggested, also properly have regard to the period reasonably required by the customer to obtain an advance validation order.

If a bank is not relieved by s 341(2) of its duty to honour a customer's payment instructions given within the scope of an overdraft facility the bank is, of course, on the horns of a dilemma: if it honours the payment instructions it may be unable to

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(30) See eg 795.

recover part or all of the monies paid out and if it refuses to honour the payment instructions it may incur a liability for damages.[31] On the other hand, the view has already been taken[32] that if a disponee was obliged to act as he did he will normally be entitled to validation. The bank's jeopardy is therefore essentially that it may be put to the inconvenience of applying for validation, not that it will be deprived of the claim it would otherwise have.

This, however, gives rise to the question of whether a bank ought to give notice withdrawing any overdraft facility granted by it to a customer, as soon as it becomes aware that a winding-up application has been presented against the customer. Obviously, a bank is very likely to do so anyway for commercial reasons but the question which arises is whether, if the bank does not do so, this will weigh against it in a subsequent application for validation of the contract of loan which arises each time the bank honours a payment instruction.

The answer is, it is suggested, that as long as the bank does not know, nor has any reason to suspect, that payment instructions are being given or are likely to be given, that would not qualify for validation, there is no onus on it to withdraw the facility. If it were otherwise the mere presentation of a winding-up application, whether well-founded or not, would prejudice the company, and the courts have recognised that their discretion should be exercised in such a way as to avoid this consequence as far as possible.[33]

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(31) Cf Hal M Bateman 'Post-Bankruptcy Transfers: An Old Problem in Need of a New Solution' (1968) Cornell Law Rev 280 at 298.

(32) See eg 607-8 above.

(33) See eg In re Wiltshire Iron Company Ex p Pearson (1868) 3 Ch App 443 at 447.

On the other hand, if the bank does know, or has reason to suspect, that payment instructions are being given, or are likely to be given, that would not qualify for validation, the bank should give notice withdrawing the facility and if it does not do so the courts may be expected to approach the question of validation as if it had done so. The effect of the courts' approaching the matter in this way would be broadly that where the bank has not given notice withdrawing the facility when it should have done so, knowledge on the part of the bank at the time of payment that the payment is not in the interests of creditors would generally disentitle the bank to validation and the bank could not rely on the fact that it is obliged to honour the payment instruction in order to contend that it is only its knowledge at the date of the grant of the facility that is relevant.(34)

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(34) See 555-7 above.

CHAPTER 16 - COMPARATIVE LEGISLATION

Synopsis

The need for anti-preference legislation is widely felt in other legal systems too. Generally the same legislative provisions apply both to *natural persons* and to companies and the legislation spells out in detail which transactions are impeachable and which are not rather than giving a wide discretion to the courts as s 341(2) does. The impeachable transactions can generally be broadly classified into 3 categories: transactions for *no or inadequate* value; the discharge of debts with the intention, or with the effect, of *preferring certain* creditors over the others; and fraudulent transfers of property. A wide diversity of approaches to these common problems is, however, to be found in the countries reviewed. This illustrates the difficulty faced by a court when called upon to exercise its discretion under s 341(2), but despite the wide diversity of approaches some guidance is to be had from the approaches of the countries reviewed as to which transactions should be upheld and which should not in the exercise of the discretion under s 341(2).

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The need for rules to ensure that *certain creditors are not* preferred at the expense of the other creditors during a debtor's slide into insolvency is widely felt in other legal systems too.[1]

In Roman and Roman-Dutch law creditors could attack a fraudulent preference under the actio Pauliana[2] and in England legislation

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(1) See generally J H Dalhuisen Dalhuisen on International Insolvency and Bankruptcy (New York 1982); I N Leh La Faillite dans le Droit European Continental (Paris 1932); Les Procedures Collectives de Liquidation ou de Renflouement des Enterprises en Droit Compare under the direction of R Rodiere L'Institut de Droit Compare de Paris (Paris 1976).

(2) See eg Voet 42.8; Fenhalls v Ebrahim & Others 1966 (4) SA 723 (D&CLD); Mars Insolvency #12.19. The action is still available in addition to the statutory rights under ss 26, 29, 30 and 31 of the Insolvency Act as applied to companies by s 339 of the Companies Act and under s 341(2) of the Companies Act.

allowing the impeachment of fraudulent conveyances was first enacted under Queen Elizabeth I.[3] The need to prove fraud, however, limited the scope of these remedies and in modern insolvency legislation the element of fraud is often dispensed with, although this has in turn generally necessitated an intricate system of exceptions to protect ordinary commercial intercourse.

Attempts to strike a balance between the interests of the creditors and the need to avoid the hampering of the free flow of trade have led to a wide diversity of legislative provisions in different countries, and legislation such as s 341(2) leaving this balancing exercise to the courts is the exception rather than the rule: most insolvency laws seek to define in detail what transactions will or will not be impeachable.[4] Different impeachment laws for companies and natural persons are similarly the exception rather than the rule.[5]

(1) England

The English Companies Act[6] contains provisions[7] similar to ss 348 and 341(2), but the English Bankruptcy Act,[8] which

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(3) 13 Eliz c 5 (1571).

(4) Sections 26, 29, 30 and 31 of the Insolvency Act are an example of this approach.

(5) The desirability of the harmonisation of our Insolvency Act and the provisions of our Companies Act relating to windings-up was recognised both by the Van Wyk de Vries Commission (Main Report # 50.02) and by the Minister of Economic Affairs on introducing the bill which was enacted as the 1973 Act (Hansard vol 44 col 6403). In England the Cork Committee reached the same conclusion in regard to the English Bankruptcy Act and the provisions of the English Companies Act relating to windings-up (Report ## 111-113).

(6) 1948.

(7) Sections 229 and 227.

(8) 1914.

deals with the insolvency of natural persons, contains provisions which differ both from s 341(2) and from the provisions of our Insolvency Act.

Section 37 of the Bankruptcy Act deems a bankruptcy to commence at the time of the act of bankruptcy on which the receiving order is made or at the time of the first such act during the 3 months preceding the presentation of the bankruptcy petition. With the exception of transactions protected by ss 45 and 46 dealt with below, all dealings by the bankrupt with his property and all payments and other transfers of property to the bankrupt after the deemed commencement of the bankruptcy are impeachable by the trustee.(9) On the other hand, debts incurred by the bankrupt are only void if the creditor had notice of an act of bankruptcy available against the bankrupt.(10)

Also impeachable are:

- any transfer of property, or charge thereon, or obligation incurred by the bankrupt, during the 6 months preceding presentation of the bankruptcy petition with a view to preferring a creditor,(11) but pressure by the creditor may negative an intention to prefer;(12)

- any settlement if made during the 10 years preceding the deemed commencement, provided that if the settlement took place more

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(9) Halsbury vol 3 'Bankruptcy and Insolvency' ## 665 and 667.

(10) Sections 30(2) and (3).

(11) Section 44(1). Section 320 of the Companies Act 1948 applies s 44 to companies.

(12) Halsbury loc cit ## 914-5.

than 2 years before such commencement the recipient may avoid impeachment by proving that the settlor was solvent immediately after making the settlement.[13] To constitute a settlement there must be an intention that the property will be retained or preserved for the benefit of the donee in a form that can be traced.[14] Special provisions apply to settlements on wives and children;[15]

- conveyances made at any time with the intention of defrauding creditors.[16]

Subject to the aforegoing provisions, s 45 protects:

(a) Any payment by the bankrupt to a creditor;

(b) Any payment or delivery to the bankrupt;

(c) Any conveyance or assignment by the bankrupt for valuable consideration;

(d) Any transaction with the bankrupt for valuable consideration;

prior to the grant of the order provided that the other party was unaware of any act of bankruptcy committed by the bankrupt.

Notwithstanding anything to the contrary in the Act, s 46 protects any payment or delivery to the bankrupt after notice of an

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(13) Section 42(1); Re Reis Ex p Clough [1904] 1 KB 451.

(14) Halsbury loc cit # 895.

(15) Section 42(1).

(16) Section 172 of the Law of Property Act 1925.

act of bankruptcy but before notice of presentation of a bankruptcy petition and before the order provided that the payment or delivery was in the ordinary course of business or otherwise bona fide.

(2) Australia

The position in Australia is broadly similar to the position in England although there are material differences. There is the same separation between companies and natural persons, the Companies Act[17] containing provisions[18] similar to ss 348 and 341(2) and the Bankruptcy Act[19] being broadly modelled on the English Act.

Section 115 of the Bankruptcy Act deems a bankruptcy to commence at the time of the act of bankruptcy on which the receiving order is made or at the time of the first such act during the 6 months (as opposed to 3 months in England) preceding the presentation of the bankruptcy petition. With the exception of transactions protected by ss 123 and 124 dealt with below, all dealings by the bankrupt with his property, and all payments and other transfers of property to the bankrupt, after the deemed commencement of the bankruptcy are impeachable by the trustee.[20] On the other hand, debts incurred by the bankrupt are not void unless they are avoided by one of the provisions dealt with below.[21] (There is no provision equivalent to s 30 of the English Act avoiding debts if the creditor had notice of an act of bankruptcy available against the debtor.)

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(17) 1981 (Cth).

(18) Sections 365(2) and 368(1).

(19) 33 of 1966.

(20) Re Docker (1938) 10 ABC 198, 245; C Darvall & N T F Fernon McDonald Henry and Meek Australian Bankruptcy Law and Practice 5th ed (Sydney 6 March 1984) 254ff.

(21) Section 82; McDonald Henry op cit 189.

Also impeachable are:

- any transfer of property, or charge thereon, or obligation incurred by the bankrupt during the 6 months preceding presentation of the bankruptcy petition or thereafter which had the effect of preferring a creditor, unless the other party proves that he acted in good faith and the ordinary course of business and was unaware of the debtor's insolvency and of the fact of the preference and he gave valuable consideration.[22] (The most important differences from the corresponding English provision are that the Australian provision also applies after presentation and an intention to prefer is not required);

- any settlement made on or after the date 5 years (not 10 as in England) before the deemed commencement, provided that if the settlement took place more than 2 years before such commencement the recipient may avoid impeachment by proving that the settlor was solvent immediately after making the settlement.[23] To constitute a settlement there must be an intention that the property will be retained or preserved for the benefit of the donee in a form that can be traced.[24] Special provisions apply to settlements on wives and children;[25]

- dispositions to defraud creditors unless for valuable consideration to a disponee in good faith.[26]

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(22) Section 122. Section 451 of the Companies Act 1981 (Cth) applies s 122 to companies.

(23) Section 120. Section 451 of the Companies Act 1981 (Cth) also applies s 120 to companies

(24) McDonald Henry op cit 299.

(25) Section 120

(26) Section 121.

Subject to the aforegoing provisions, s 123 protects:

(a) Any payment by the bankrupt to a creditor;

(b) Any conveyance, transfer or assignment by the bankrupt for valuable consideration;

(c) Any transaction with the bankrupt for valuable consideration;

(d) Any transaction to the extent of a present advance made by an existing creditor;

provided that the other party proves that:

(i) The transaction took place before the bankruptcy order;(27)

(ii) He had no notice of the presentation;

(iii) The transaction was in good faith and the ordinary course of business.

Knowledge of an act of insolvency is deemed not to *per se* preclude good faith.

(The English Act contains no counterpart of (d).)

Notwithstanding anything to the contrary in the Act, s 124 protects payments and deliveries to the bankrupt provided that the other party proves they were made in good faith and the ordinary course of business and, if made after the order, without negligence.

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(27) McDonald Henry *op cit* 328.

Knowledge that the debtor was unable to pay his debts or of an act of bankruptcy or of the presentation of a bankruptcy petition is deemed not to per se preclude good faith. (The corresponding English section only applies before notice of presentation and before the order.)

(3) India

The position in India is broadly similar to the position in England although in addition to the Companies Act[28] there is not only one but 2 Insolvency Acts: the Presidency-Towns Insolvency Act[29] which applies in Bombay, Calcutta and Madras and the Provincial Insolvency Act[30] which applies in the rest of India. The Companies Act contains provisions[31] similar to ss 348 and 341(2) of our Act and the Insolvency Acts are modelled on the English Bankruptcy Act, although they contain material differences from that Act and from one another.

The principal differences between the Indian Acts and the English Act are as follows: The Provincial Insolvency Act only relates the insolvency back to the presentation of the insolvency petition,[32] although the Presidency-Towns Act follows the English model.[33] Neither of the Indian Acts contains provisions

(28) 1 of 1956.

(29) 3 of 1909.

(30) 5 of 1920.

(31) Sections 441(2) and 536(2).

(32) Section 28(7).

(33) Section 51.

similar to ss 30(2) and (3) of the English Act providing that debts incurred by the insolvent are void if the creditor had notice of an act of bankruptcy available against the bankrupt, but not otherwise. Fraudulent preferences can only be set aside if made during the 3 months preceding presentation, not 6 months.[34]

The Indian Acts contain no provisions regarding settlements but instead avoid all transfers of property, except to a purchaser or incumbrancer in good faith and for valuable consideration, during the 2 years preceding his being adjudged insolvent in the case of the Presidency-Towns Act,[35] or preceding the presentation in the case of the Provincial Act.[36] Bona fide transactions before the other party had notice of an act of insolvency are protected as in s 45 of the English Act except that the other party must have been unaware of the presentation, not of an act of insolvency committed by the insolvent, for the protection to apply.[37] There is no provision equivalent to s 46 of the English Act protecting transactions after notice of an act of insolvency but before notice of presentation.

(4) Canada

The Canadian Bankruptcy Act[38] applies both to natural

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(34) Section 56 of the Presidency-Towns Act and s 54 of the Provincial Act. Sections 531 of the Companies Act 1956 applies these provisions to companies except that the period is 6 months. Moreover, under s 531A transfers not in the ordinary course of the company's business or not in good faith and for value within one year before presentation are void.

(35) Section 55.

(36) Section 53.

(37) Section 57 of the Presidency-Towns Act and s 55 of the Provincial Act.

(38) RSC 1970 c8-3.

persons and to companies[39] and is broadly similar to the English Bankruptcy Act.

The principal differences between the Canadian and English Acts are as follows. The Canadian Act relates the bankruptcy back to the filing of the bankruptcy petition, not to the act of bankruptcy on which the receiving order is made or the first such act during the 3 months preceding presentation.[40] The Canadian Act does not contain provisions similar to ss 30(2) and (3) of the English Act providing that debts incurred by the insolvent are void if the creditor had notice of an act of bankruptcy available against the bankrupt, but not otherwise. Fraudulent preferences can only be set aside if made during the 3 months preceding filing of the petition (12 months if the other party is related to the bankrupt), not 6 months.[41] If the transaction has the effect of preferring a creditor, an intention to prefer is rebuttably presumed and evidence of creditor pressure is not admissible to support the transaction.[42]

The Canadian provision[43] regarding settlements is similar to the English provision except that the periods are 5 years and 1 year, not 10 and 2, and the onus is expressly placed on the trustee. Moreover, if the bankrupt during the 12 months before becoming bankrupt sold, purchased, leased, hired, supplied or received property or services in a non-arm's length transaction and the consideration was conspicuously greater or less than the fair market consideration the court can order the other party to pay the

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(39) Definition of 'person' in s 2.

(40) Section 50(4). The wide interpretation placed on this provision has been considered at 253-5 above.

(41) Sections 73(1) and 74; Houlden & Morawetz Bankruptcy Law F132.

(42) Section 73(2).

(43) Section 69.

difference to the trustee.[44]

The Canadian counterpart[45] of s 45 of the English Act differs from the English provision in the following respects:

- where the English section refers to 'valuable consideration' the Canadian section refers to 'adequate valuable consideration', which is defined as 'consideration of fair and reasonable money value';

- one of the requirements for the operation of the Canadian section is that the party seeking its protection must have been in good faith.

There is no provision equivalent to s 46 of the English Act protecting transactions after notice of an act of insolvency but before notice of presentation.

(5) United States

The provisions of the United States Bankruptcy Code[46] are the most detailed of the countries reviewed.

The starting point of the Code for present purposes is s 541(a) which provides that the bankrupt estate consists in the first instance of the property of the debtor at the date of filing of the bankruptcy petition. It would follow in the absence of provision to the contrary that no payment or delivery by or to the debtor thereafter in respect of a debt falling into the estate would be

(44) Section 78 read with s 3.

(45) Section 75.

(46) 1978, 11 USC, which applies both to natural persons and companies.

valid nor would any debt incurred by the debtor thereafter be provable against the estate.[47] These consequences are, however, mitigated by a number of provisions:

- payment or delivery to the debtor in good faith and without notice of the filing is valid, even if it takes place after the grant of the order;[48]

- payment or delivery to a third party in accordance with the debtor's directions in good faith and without notice of the filing is valid insofar as the person making payment or delivery is concerned, even if payment or delivery takes place after the grant of the order.[49] The payment or delivery is also valid insofar as the third party is concerned save to the extent it may exceed the value given by the third party after filing;[50]

- the debtor may, unless the court otherwise orders, continue his business until the grant of the order and any payment or delivery effected by him in so doing is valid,[51] save to the extent it may exceed the value given by the other party after filing;[52]

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(47) Similarly, property acquired after filing is generally excluded from the estate - Collier Bankruptcy ¶ 541-05.

(48) Section 542(c).

(49) Section 542(c).

(50) Section 549(a) and (b).

(51) Section 303(f).

(52) Section 549(a) and (b).

- any debt incurred by the debtor in the ordinary course of his business or financial affairs before the grant of the order, or, if earlier, the appointment of an interim trustee,[53] may be proved against the estate.[54]

The Code also contains a number of provisions for the avoidance of pre-filing transactions:

- s 547 avoids any transfer of property (including the furnishing of security) to a creditor for an existing debt at a time when the debtor was factually insolvent,[55] if made during the 90 days preceding filing (one year in the case of certain insiders[56]) which results in a preference to the creditor, subject to the following principal exceptions:

  (a) a transfer in consideration of new value given by the transferee;

  (b) payment of a debt made in the ordinary course of business or financial affairs of both parties and

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(53) Section 303(g) provides for the appointment of an interim trustee at any time after filing.

(54) Section 502(f).

(55) Section 547(f) presumes the debtor's factual insolvency during the 90 days preceding filing. The effect of this 'is merely to shift the burden of going forward, and not the burden of proof' - rule 301 of the Federal Rules of Evidence.

(56) Certain defined persons closely related to or associated with the debtor and who had reasonable cause to believe that the debtor was insolvent at the time.

incurred in such ordinary course, if made according to ordinary business terms within 45 days after the debt was incurred;[57]

- if a creditor holds a security interest in the debtor's debts or stocks, the creditor's position may not improve during the 90 days (one year in the case of certain insiders[58]) preceding filing due to an increase in the debts or stocks (other than due to fluctuations in market value);[59]

- s 548(a)(1) avoids any transfer of property or assumption of any obligation during the year preceding filing if madewith intent to hinder, delay or defraud present or future creditors. Such intent is not required on the part of the other party;

- s 548(a)(2) avoids any transfer of property or assumption of any obligation during the year preceding filing if made without equivalent value having been given and if:

  (a) the debtor was factually insolvent immediately afterwards;

  (b) the debtor was a businessman and was left with inadequate capital; or

  (c) the debtor was too illiquid to meet his debts as they fell due.

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(57) Creditor pressure does not operate to exempt an otherwise preferential transfer, and the debtor's intent or motive is not a material factor - Collier Bankruptcy # 547.01.

(58) See note 56 above.

(59) Section 547(c)(5); Collier Bankruptcy # 547.41.

(6) France[60]

There is no general provision under the French insolvency legislation[61] for the relation back of an insolvency. An order of insolvency is effective from the time it is granted and the general rule is that all acts preceding the grant of the order are valid.[62] The French Act does, however, avoid certain specific acts which take place after the 'cessation of payments' by the insolvent.

The expression 'cessation of payments' is not defined but has been held to mean the failure to pay one's debts as they fall due.[63] This may or may not coincide with actual insolvency. The mere failure to pay one or more debts timeously is not sufficient; there must be proof that the debtor is 'dans une situation financière désespérée et dans un total dénuement de crédit'.[64] The court fixes the date of cessation at the time of granting the insolvency order[65] but may modify it later.[66] The date may

(60) See generally C Livadas The Winding-up of Insolvent Companies in England and France (Deventer 1983)

(61) Loi 67-563 of 13 July 1967, which applies both to natural persons and to companies.

(62) G Bord Règlement Judiciaire et Liquidation des Biens (Paris 1969) ## 353 and 388.

(63) J Argenson & G Toujas Règlement Judiciaire Liquidation des Biens Faillite 4th ed (Paris 1973) # 9ff.

(64) Loc cit 24: 'in a hopeless financial situation and with all credit exhausted'.

(65) Sections 6 and 29.

(66) Section 30.

not be more than 18 months before the order.[67] In the majority of cases the date of cessation is fixed as the date of the order[68] and if the court makes no order fixing the date the date is automatically deemed to be the date of the order.[69]

The following post-cessation acts are avoided by s 29,[70] irrespective of whether the other party was in good faith or unaware of the cessation, provided that they caused prejudice to the body of creditors:

- gratuitous transfers of property including marriage settlements;

- contracts where the insolvent's obligations markedly exceed the other party's obligations;

- the payment of debts before maturity if the date of maturity is after the insolvency order, but this does not apply to payments on running account,[71] and the payment of bills of exchange is also afforded certain protection;[72]

- the payment of debts otherwise than in a normal manner. Payment in cash, by a bill of exchange or by money transfer is expressly stated to be normal. Payment in the manner contemplated by the

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(67) Section 29.

(68) Bord op cit # 80.

(69) Section 6.

(70) See generally Bord op cit ## 388 ff; Argenson & Toujas op cit ## 430 ff.

(71) Bord op cit # 394; Argenson & Toujas op cit # 441.

(72) Section 32.

contract is likewise normal.[73] Payment by delivery of goods, cession of a debt, datio in solutum or delegation of the debt is abnormal.[74] Compulsory payments, eg pursuant to execution of a judgment, are normal;[75]

- the furnishing of security for an existing debt.

Moreover, the court has a discretion[76] to invalidate certain acts as follows:

- gratuitous transfers of property including marriage settlements, during the 6 months preceding cessation;

- if the other party was aware of the cessation:

  (a) the payment of any debt which is not automatically invalid under s 29, except for involuntary payments;[77]

  (b) any prejudicial transaction such as a purchase at an excessive price; a sale at a very low price; a lease on abnormal conditions; a disadvantageous compromise.[78]

In addition, s 1167 of the Civil Code avoids any act of the insolvent which caused or increased the insolvency if the insolvent acted with the intention to defraud his creditors and the other party was a party to the fraud.[79]

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(73) Bord op cit # 397.

(74) Bord op cit # 400.

(75) Ibid.

(76) Section 31.

(77) Bord Liquidation # 417.

(78) Argenson & Toujas Liquidation 479.

(79) Bord Liquidation # 430.

(7) Netherlands[80]

There is no general provision under the Dutch Faillissementswet[81] for the relation back of an insolvency.[82] The Act does, however, avoid certain specific acts although the range of acts concerned is the most limited of the countries reviewed:

- s 44 avoids donations if the insolvent knew that the donation would prejudice the creditors whether or not the donee shared such knowledge. Donations are rebuttably presumed to have been made with such knowledge if made within 40 days before the insolvency order (80 days if to a relative up to the third degree).[83] The giving of security for an existing debt is not a donation[84] even if the debt is not due and payable.[85] Otherwise 'schenkingen' has a wide meaning.[86] The beneficiary is not liable to restore the donation to the extent it was consumed before he became aware of the donor's financial position;[87]

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(80) See generally A van den Ende Faillissementswet (Deventer October 1983).

(81) Wet van den 30sten September 1893 (staatsblad 140) op het Faillissement en die Surséance van Betaling, including amendments up to that of 13 April 1978 (staatsblad 255).

(82) Section 23. Prior to 1893 an insolvency dated back to the date of the petition but this was rejected by the commission which preceded the 1893 Act - WLPA Molengraaff & CW Star Busmann De Faillissementswet 4th ed (Zwolle 1951) 176 ff.

(83) Section 46.

(84) Hof's-Gravenhage 18 November 1960, NJ 1961, 502.

(85) Hof's-Hertogenbosch 14 June 1965, NJ 1967, 232.

(86) Molengraaff & Busmann op cit 240.

(87) Section 46; Molengraaff & Busmann op cit 239-243.

- s 42 avoids any act, other than the discharge of a valid debt,[88] which the parties knew would prejudice creditors. The required knowledge is rebuttably presumed[89] if the act took place during the 40 days preceding the insolvency order and if:

  (a) the value of the debtor's obligations markedly exceeded those of the other party;

  (b) the act consisted in the discharge or securing of obligations which were not yet due and payable; or

  (c) the act was with or in favour of the debtor's spouse or a relative up to the third degree;

- the discharge of a due and payable debt is only avoided if the other party knew that application had already been made for an insolvency order or if the discharge took place pursuant to an express agreement[90] between the parties to prefer the creditor.[91]

(8) Germany[92]

There is no general provision under the German Konkursordnung[93] for the relation back of an insolvency. The following specific acts are, however, avoided :

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(88) Op cit 224 ff.

(89) Section 43.

(90) Hof Amsterdam 27 June 1940, NJ 1941, 258.

(91) Section 47. Section 48 affords the payment of bills of exchange some protection from the provisions of s 47.

(92) (89) See generally M Peltzer German Insolvency Laws (Cologne 1975) 40-6 and 207-8.

(93) Of 10 February 1877 (RGBL S 351).

- transactions entered into after cessation of payments or after application for initiation of insolvency proceedings if creditors are prejudiced and if the other party was aware of the cessation or application;(94)

- the giving of security and the discharge of debts after such cessation or application if the creditor was aware of the cessation or application;(95)

- the giving of security and the discharge of debts after such cessation or application, or within 10 days before the cessation or application, to which the creditor was not entitled or not in such manner or not at such time, unless the creditor proves that he was not aware of the cessation, the application or any intention to prefer him;(96)

- legal acts performed by the insolvent with the intention known to the other party to prejudice his creditors;(97)

- prejudicial contracts entered into by the insolvent during the year preceding initiation of insolvency proceedings with members of his family unless the other party proves that he was unaware of any intention to prejudice creditors;(98)

- donations made during the year (2 years in the case of the insolvent's spouse) preceding initiation of the insolvency proceedings.(99)

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(94) Section 30(1).

(95) Ibid.

(96) Section 30(2).

(97) Section 31(1).

(98) Section 31(2).

(99) Section 32.

Section 33 provides that legal acts performed more than 6 months prior to the initiation of insolvency proceedings cannot be set aside on the grounds of awareness of the cessation of payments. Section 34 provides certain protection for payments pursuant to bills of exchange.

The last 3 categories of avoided acts listed above can also be set aside independently of insolvency proceedings under the Gesetz betreffend die Anfechtung von Rechtshandlungen eines Schuldners ausserhalb des Konkursverfahrens.(100)

(9) Conclusion

The diversity of solutions in the countries reviewed to a common problem illustrates the difficulty facing a court when called upon to exercise its discretion under s 341(2). The diversity of solutions also makes it difficult to extract principles from the approaches in other legal systems as guidance in the exercise of the discretion conferred by s 341(2). Nevertheless, the approaches of other legal systems do, it is thought, give some indication of the types of transaction which should properly be upheld and those which should be struck down.

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(100) Of 21 July 1879 (RGBL S 277).

PART III

CONCLUSIONS - REMEDIAL LEGISLATION

CHAPTER 17 - LOSS OF CAPACITY TO ACT

The uncertainties dealt with in Part I in regard to the legal position if a bank honours a customer's cheques and other payment instructions without knowledge that the customer has ceased to have capacity to act, whether due to insanity, inability to manage his affairs, declaration as a prodigal, sequestration, winding-up or otherwise, make remedial legislation desirable to clarify the position.

The view taken in Part I[1] was that the public interest is best served if apparently regular cheques and other payment instructions are fully effectual as between bank and customer until the bank becomes aware of the customer's loss of capacity to act. True, the better view is that this is in any event the position as the law stands,[2] but the position is not free from doubt, and it is suggested that, in order to eliminate the uncertainty, s 73 of the Bills of Exchange Act 34 of 1964 should be amended along the following lines:

73(1) The duty and authority of a banker to pay a cheque drawn on him by a customer shall terminate if before paying the cheque :

(a) the banker receives notice at the branch on which the cheque is drawn countermanding payment, provided that the banker shall not be obliged to act on a countermand unless it is in writing and is signed in a manner which would be binding between the banker and the customer if it were a cheque; or

(b) the banker becomes aware at the branch on which the cheque is drawn that the customer has ceased to have capacity to act.

---

(1) See 85-8 above.

(2) See 89-91.

(2) A customer shall be deemed to have ceased to have capacity to act for the purposes of this section if he has ceased to have capacity to draw cheques for any reason, including without limitation :

(a) death;
(b) insanity;
(c) inability to manage his affairs;
(d) declaration as a prodigal, unless the court otherwise orders;
(e) sequestration of his estate, unless the cheque does not relate to the estate;
(f) winding-up; and
(g) judicial management.

(3) The provisions of paragraph (b) of sub-section (1) shall not apply to a cheque drawn by the executor, trustee, liquidator, judicial manager or other legal representative of the customer.

(4) Until the banker becomes aware of the customer's loss of capacity to act a cheque drawn by the customer shall have the same effect for all purposes as between the banker and the customer as if the customer had not ceased to have capacity to act, whether the customer drew or issued the cheque before ceasing to have capacity to act or purported to draw or issue the cheque after ceasing to have capacity to act. In particular :

(a) to the extent the cheque is drawn against a credit in the customer's account, payment of the cheque shall constitute a pro tanto discharge of the banker's indebtedness to the customer and the banker shall be entitled to set off its charges against any remaining credit;

(b) to the extent the cheque is not drawn against a credit in the customer's account, the banker shall be entitled to prove such claim against the customer's estate as it would have been entitled to prove had the customer not ceased to have capacity to act, whether for capital, interest, bank charges or otherwise, and such claim shall be preferent or secured to the same extent it would have been had the customer had capacity to act at the time of payment.

(5) If a banker pays a customer's cheque after the customer has ceased to have capacity to act :

(a) the recipient of the payment, or his principal if he is an agent, shall on written demand refund the payment to the legal representative of the customer's estate if the payment is protected in favour of the banker under sub-section (4), or to the banker if the payment is not so protected;

(b) the rights and obligations of all the parties to the cheque shall be determined as if :

(i) the cheque had been due and had been presented for payment, and

(ii) payment had been refused on the ground of the customer's loss of capacity to act,

on the first business day after receipt of the demand under paragraph (a);

(c) the person liable to make payment under paragraph (a) shall be entitled to recover the cheque from whomever is in possession thereof;

provided that the provisions of this sub-section shall not apply if the banker was bound to the recipient, or his principal, as the case may be, to pay the cheque, whether as acceptor, surety, aval, guarantor or otherwise.

(6) A banker shall not be deemed to have constructive notice of a customer's loss of capacity to act by reason of the registration of any document in any public office or the grant by a court of any order or otherwise.

(7) If a customer regains capacity to act the banker's duty and authority to honour a cheque drawn and issued by the customer prior to his loss of capacity shall be re-instated provided that :

(a) the banker's duty and authority have not also terminated for any other reason;

(b) the cheque is re-presented for payment if payment has already been refused.

(8) If a banker receives information which causes him to suspect, or which would cause a reasonable banker to suspect, that a customer has ceased to have capacity

to act he shall make such further enquiry as he reasonably can to determine whether or not the customer has ceased to have capacity to act.

(9) If a banker wrongly but reasonably believes after due enquiry that a customer has ceased to have capacity to act the banker shall not be liable for damages for wrongful dishonour of any cheques dishonoured by the bank in reliance on such belief.

(10) If a person whom the customer has authorised to draw or issue cheques on the customer's behalf:

(a) draws or issues a cheque before ceasing to have capacity to act the cheque shall be unaffected if that person thereafter ceases to have capacity to act;

(b) draws or issues a cheque after ceasing to have capacity to act due to other than due to insanity or inability to manage his affairs the cheque shall be fully effectual as between the banker and the customer;

(c) purports to draw or issue a cheque after ceasing to have capacity to act due to insanity or inability to manage his affairs the provisions of sub-sections (4) to (9) shall apply mutatis mutandis.

(11) The provisions of this section shall apply mutatis mutandis to payment instructions given otherwise than by cheque.

CHAPTER 18 - SECTIONS 348 AND 341(2) OF THE COMPANIES ACT

Sections 348 and 341(2) must be seen as part of a group of anti-preference provisions aimed at securing a fair distribution of an insolvent company's assets. The other provisions in this group of anti-preference provisions are the impeachment sections[1] of the Insolvency Act as imported into the Companies Act by s 340, together with the common law actio Pauliana.

The impeachment sections of the Insolvency Act contain extensive provisions for the impeachment of dispositions for no or inadequate value, voidable and undue preferences and collusive dealings and it is difficult to see what further transactions the legislature may have wished to avoid in enacting ss 348 and 341(2). When the concept embodied in ss 348 and 341(2) was first introduced the position was very different in that the other anti-preference provisions were of limited scope, but, with respect, the concept now embodied in ss 348 and 341(2) outlived its usefulness when it was re-enacted in the 1926 Act despite the incorporation in that Act of the Insolvency Act impeachment sections.

The objection to ss 348 and 341(2), however, goes well beyond simple superfluity. As pointed out in Part II, the sections can be the cause of considerable hardship both to the company itself and to persons dealing with the company, and although the courts have the power to validate any transaction avoided by the sections, this has not in practice proved a satisfactory protection against hardship in other countries which have similar provisions in their companies legislation.

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(1) Sections 26, 29, 30 and 31.

In short, ss 348 and 341(2) are not only superfluous but also positively harmful. They are a blunt instrument which does not distinguish between tainted and untainted transactions and which is unsuited to the complex problems that arise in relation to transactions in the period leading up to the winding-up of a company.

The law should not only assail bad faith but should also protect good faith. It should also protect transactions in the ordinary course of business because failure to do so is prejudicial to commerce. Sections 348 and 341(2), with respect, fail in both these respects.

The solution is, it is considered, that ss 348 and 341(2) should be repealed and the field left to be governed by the Insolvency Act impeachment sections as imported into the Companies Act. The Insolvency Act sections have worked well in practice and although it is true that ss 348 and 341(2) have not as yet given rise to serious problems in practice in this country, the reason for this is, it is thought, that they have been largely ignored in practice here, and it is believed that it can be confidently predicted that if the sections are not repealed they will inevitably give rise to problems similar to those that have arisen in England, Australia and India.

In Australia some steps have been taken to eliminate the uncertainties in the Australian counterparts of ss 348 and 341(2)[2] but extensive further amendment would be needed to

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(2) By making it clear that 'presentation' means 'filing', that the section does not apply to dispositions by the liquidator, that application for validation can be made in advance and that the courts can validate the continued conduct by a company of its business in general terms - see ss 365 and 368 of the Companies Act 1981 (Cth).

eliminate all the uncertainties. In England, on the other hand, it is noteworthy that the English counterparts of the sections find no place in the sweeping reforms of the laws relating to insolvency, including the harmonisation of the laws relating to bankruptcy and winding-up,[3] proposed by the Cork Commission on Insolvency Law and Practice in England.[4]

The desirability not only of the harmonisation of our Insolvency Act and the provisions of our Companies Act relating to windings-up but also specifically of bringing the winding-up provisions into line with the Insolvency Act and not vice versa, was recognised by the Van Wyk de Vries Commission,[5] and the repeal of ss 348 and 341(2) would obviously be in accord with this objective.

Our law relating to winding-up is based on the English model which has not only been described by as eminent an authority as Gower[6] as 'confused and muddled' but which will, as already mentioned, be swept away if the Cork Commission's recommendations

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(3) Report ## 111-13.

(4) Loc cit # 1280 and chapter 10.

(5) Main Report # 50.02. See too the speech of the Minister of Economic Affairs on introducing the bill which was enacted as the 1973 Act - Hansard vol 44 col 6403. See too 563-4 above.

(6) Company Law 740.

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are accepted. There is therefore little reason for our legislature to hesitate to amend our law by ridding it of the anachronism represented by ss 348 and 341(2).(7)

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(7) It is perhaps noteworthy that the Insolvency Act originally contained a section reading:

> '29(2) If the liabilities of a debtor who has borrowed money from a bank by overdrawing his account with that bank, upon any date within the period of six months immediately preceding the sequestration of his estate exceeded the value of his assets, then all payments made by that debtor to that bank after the said date may be set aside by the Court, in so far as the total of those payments exceeds the total of all sums lent by the said bank to the said debtor after the said date'

but that the section was repealed in 1960. The reason given in the Explanatory Memorandum on the Various Clauses in the Finance Bill, 1960 (WP 10 -'60) for the proposal to repeal the section was as follows:

> 'The result [of s 29(2) of the Insolvency Act] is that banks are obliged to restrict credit facilities, often in cases where such facilities are most needed with consequent adverse effect upon, amongst others, traders, contractors and farmers.'

Similar reasoning is, it is thought, equally applicable to ss 348 and 341(2).

INDEX

AGENCY - See REPRESENTATION, MANDATE

BANK CUSTOMER CONTRACT - See BANK CUSTOMER RELATIONSHIP

BANK CUSTOMER RELATIONSHIP (See also BANK'S DUTY AND AUTHORITY, CHEQUES AND OTHER PAYMENT INSTRUCTIONS, MANDATE, OVERDRAFT, PAYMENT, TERMINATION OF BANK'S DUTY AND AUTHORITY)

bank customer contract....6-14

bank customer relationship, distinguished from....21

mandate....6-14

single contract of mandate, not recurrent contracts 13-14

services automatically impliedly undertaken....8-9

services only undertaken if there is a separate *contract*....*9 n 9*

services only rendered if the customer avails himself thereof....13-14

services rendered automatically....13

classification....4-21

bank customer relationship and bank customer contract distinguished....21

combination of a contract of mandate - the bank customer contract - and one or more contracts of loan (mutuum)....6-21

commodatum....17

conventional description....5-6

depositum....17-18

depositum irregulare....17-18

locatio conductio operarum and operis....7 n 6, 12, 68 n 108

loan (mutuum)....14-21

customer has option to lend to bank....20-1

BANK CUSTOMER RELATIONSHIP cont.
classification cont.

overdraft is option to borrow....21

recurrent contracts of loan, not a single contract....19-21

mandate....6-14

single contract of mandate, not recurrent contracts....13-14

representation (agency)....11 n 17, 38 n 24

sui generis....12-13

unfortunate practical consequences of classification of bank customer contract as mandate....7 n 6

generally....4-27

term that cheques and other payment instructions are fully effectual as between bank and customer until bank becomes aware of customer's loss of capacity .... 34-92, see also TERMINATION OF BANK'S DUTY AND AUTHORITY

termination....35, 141, 633-46

BANK'S DUTY AND AUTHORITY (See also BANK CUSTOMER RELATIONSHIP, CHEQUES AND OTHER PAYMENT INSTRUCTIONS, TERMINATION OF BANK'S DUTY AND AUTHORITY)

credit, customer's account in....21-2

meaning....24-5

overdraft, customer's account in....22-4

overdraft facility agreed....22-3

overdraft facility not agreed....23-4

CHEQUES AND OTHER PAYMENT INSTRUCTIONS (See also BANK CUSTOMER RELATIONSHIP, BANK'S DUTY AND AUTHORITY, PAYMENT, TERMINATION OF BANK'S DUTY AND AUTHORITY)

functions....21-3

demand....21-3

exercise of option....21 3

CHEQUES AND OTHER PAYMENT INSTRUCTIONS cont.
functions cont.

indivisibility....140-2

offer to borrow....23

acceptance normally occurs on the honouring of the cheque or payment instruction....145

payment direction....21-3

exercise of the right to services undertaken by bank....22 n 39, 141 n 295

'payment instruction', distinguished from 'payment direction'....22 n 38

payment instructions other than cheques, legal effect of....27

COMPANIES

applicability of s 22 of the Insolvency Act to....185-9

applicability of s 73(c) of the Bills of Exchange Act to....172-4

constructive notice, the company law doctrine of....220-5

does the doctrine apply to s 73(c) of the Bills of Exchange Act, s 22 of the Insolvency Act as applied to companies and the common law relating to the termination of a bank's duty and authority?....222-5

is a winding-up order a public document?....221-2

judicial management does not establish concursus creditorum....166-7

winding-up

establishment of concursus creditorum....166-8

not established if company is able to pay its debts....166-7

loss of capacity on....165

terminates mandate....166

terminates offer....167 n 20, 207 n 133

CONDITIONAL REAL RIGHTS....364 n 116

CONTRACT (See also BANK CUSTOMER RELATIONSHIP, MANDATE, NEGATIVE INTEREST, PAYMENT, REPRESENTATION)

implied (tacit) terms....80-9

business efficacy test....80-4

officious bystander test....80-4

reasonable necessity test....84-5

naturalia (natural incidents), sources....76-79, 89-91

custom....76, 90

legislation....76, 90

old authorities....76-77, 90

recognition of new naturalia by the courts....76-79, 89-91

trade usage....76, 90

notice exercising right under contract

loss of capacity after notice has been despatched but before it is received. 134-5, 139

loss of capacity after notice has been received....139

reliance by one party on the other party's continued capacity to act....149

time at which addressor and addressee must have capacity....134-5, 139

time at which notice takes effect....133-4

offers lapse on offeror's loss of capacity....72-4, 167 n 20, 206-7

exception if parties agree otherwise....72-4

rights of offeree who 'accepts' offer and performs his 'obligations' in ignorance of the offeror's loss of capacity....109-26, 147-8

option

analogy with contract subject to potestative *suspensive condition....14 n 21, 374 n 136*

CONTRACT cont.
option cont.

distinguished from election to avail oneself of right under a contract....13-14

does not necessarily lapse on offeror's loss of capacity....72-4

reliance by one party on other party's continued capacity to give or receive notice exercising option....149

reliance on another's continued capacity to act, a general rule that person so relying is entitled to be indemnified for his negative interest?....145-54, see further NEGATIVE INTEREST

sui generis contracts, presumption against....13 n 20

terms, sources

express terms....76

implied (tacit) terms....76

naturalia (natural incidents)....76

COVERING SECURITY

is date of establishment of security or date secured debt arises the date which determines ranking of the security?....365

DISCRETION

dangers inherent in wide discretion....236-7

scope of court's discretion under s 341(2) of the Companies Act....493-4

DISPOSITION (See also PRESENTATION OF WINDING-UP APPLICATION, SECTIONS 348 and 341(2) OF THE COMPANIES ACT, VALIDATION)

abandonment....443-4

acceptance of bill....427-32

accessio....454

appointment, exercise of power of....467

arbitration....467

attachment and execution....454-5

DISPOSITION cont.

'by the company' - involuntary dispositions....356-61

cancellation of a contract....447-50

by agreement....447

pursuant to a breach of the contract....448-50

pursuant to a provision of the contract....448

return of payments or property pursuant to cancellation....447-50

cash deposit, see 'security' below

cession as security, see 'security' below

commixtio....454

compromise....444-5

conditional dispositions....361-73

resolutive conditions....368-73

condition in the discretion of one of the parties....370-3

condition not in the discretion of either party....369-70

suspensive conditions....361-67

condition in the discretion of one of the parties....365-7

condition not in the discretion of either party....362-4

contract as a whole must be looked at, and not the rights alone, to determine whether property has been disposed of....371, 445-50

contract, conclusion of....337-51

counterindemnities....432-3

court order, dispositions in compliance with....454-8

consent order....457-8

taking of possession under notarial bonds....456-7

DISPOSITION cont.

dispositions generally, eg continued conduct of business, validation of....490-2

division....453

donation....433

depositum....439

drawing of bill....427-32

exchange....433

execution, attachment and....454-5

expropriation....458

generally....312, 467, 486-92

habitatio....436

honouring of a customer's payment instructions....375-421

customer's account in credit....375-95

bank's right to its charges....392-4

instructions to make payment to the customer....375-81

instructions to make payment to third parties....381-91

set-off of the bank's charges against the credit in the account....394-5

customer's account in overdraft....395-421

bank's right to its charges....398-9

contract of loan....396-7

is the bank's claim secured by any security it may hold?....399-421, see also 'security' below

payment pursuant to the payment instruction....397

indemnities....432-3

indorsement of bill or promissory note....427-32

Insolvency Act definitions of 'disposition' and 'property', application to s 341(2)....325-34

DISPOSITION cont.

involuntary dispositions....356-61

lease....436-8

liens....440-3

loans by company....425-6

loans of property other than money....438-9

loans to company....396-7

loss of rights by inaction....450-2

making of promissory note....427-32

meaning....334-51

'disposition' appears in many other statutes but interpretations of its meaning in those statutes is of limited value in interpreting s 341(2)....336-7

disposition need not be in favour of creditor....335-6

increase in net deficit or reduction in net surplus not relevant....334-5

Insolvency Act definition....337-8

includes the conclusion of a contract for the transfer of a real right....227-8

ordinary meaning if Insolvency Act definition does not apply....338-51

excludes the conclusion of a contract for the transfer of a real right....338-51

unnecessary that parties should have been aware that disposition was taking place....336

mortgage, see 'security' below

negotiation of bill or promissory note....432

nominee dealings by....464-6

[illegible], see 'security' below and 456-7

novation, see 'variation' below

DISPOSITION cont.

obligations

failure to avoid obligations....452

incurrence of by contract....334-51

incurrence of otherwise than by contract....466

options....373-5, 452-3

part of a disposition, validation of....490-2

payment by company....423

to representative of payee....424

to intermediary as principal for onward payment to creditor....424-5

payment to cessionary....423

payment to company....375-81

payment to representative of company....422

payment to third party in accordance with company's directions....381-91

pledge, see 'security' below

post-winding-up dispositions, validation of....486-8

pre-emption, rights of....452-3

prescription....450-2

'property', meaning....351-5

attorney's trust account....352-3

contingent rights....352

if the Insolvency Act definition applies....353-4

if the Insolvency Act definition does not apply....354-5

purchase....434

rights

failure to take up....452

transfer of....337-51

DISPOSITION cont.

sale....433

security....399-421

cash deposit....420-1

cession as security....411-17

further disposition occurs as each ceded debt arises....414-7

disposition occurs when secured debt is incurred if later than establishment of security....404-11

giving of security is a disposition....400-4

mortgage....400-4

notarial bonds....4[illegible]

further d[illegible]n occurs as each asset comes within the [illegible]ation of bond....420

pledge....400-4

services, rendition of....435

servitude....436

set-off....394-5

shares, issue of....459-64

specificatio....454

suretyship by company....426-7

transfer of ownership....434-5

to third party in accordance with company's directions....435

transfer of real right....337-51

usufruct....436

usus....436

variation and novation....445-7

DISPOSITION cont.

void or voidable....312-19

property acquired in good faith by third party from disponee....312-19

who may avoid disposition....312-19

waiver....443-4

GOOD FAITH....153, 209-10, 526-45

IMPLIED TERMS - See CONTRACT

INABILITY TO MANAGE ONE'S AFFAIRS - See TERMINATION OF BANK'S DUTY AND AUTHORITY

INSANITY - See TERMINATION OF BANK'S DUTY AND AUTHORITY

INSOLVENCY - See TERMINATION OF BANK'S DUTY AND AUTHORITY

INTERPRETATION

absurdity, presumption against....257

change in language gives rise to presumption that a change in meaning was intended....285

changes prompted solely by draftsman's desire to make language more elegant....285

scant attention paid to presumption in Companies Act....299, 328, 333-4

change in law, presumption against....286 n 35

contra fiscum....361

Corpus Iuris

contradictions in....71 n 116

misinterpretation by Roman-Dutch jurists....55

deprivation of rights, presumption against....241

different words have different meanings, presumption....299, 333-4

scant attention paid to presumption in Companies Act....299, 328, 333-4

expressio unius est exclusio alterius....191

INTERPRETATION cont.

foreign authority, weight to be accorded to....242-54

decisions in jurisdictions other than England....247

English decisions on the English Companies Act....243-7

prior to adoption of legislation in South Africa....244-7

historical background to statute....329-31

intention of the legislature, cardinal rule of interpretation....177 n 45

at the time of the enactment of the statute....330

interference with rights, presumption against....241

practice, interpretation placed on ambiguous legislation in....270-1

provision incorporated from another Act....327

regulations, reference to as aid to interpreting statute....286-8

similar words have similar meanings, presumption....299, 328

especially where same word repeated in same sentence....328

scant attention paid to presumption in Companies Act....299, 328, 333-4

specific provision takes precedence over general provision even where general provision appears in later enactment....181

superfluity, presumption against....266

JUDICIAL LAW-MAKING....50, 77-9, 360

LIQUIDATION - See TERMINATION OF BANK'S DUTY AND AUTHORITY

MANDATE (See also REPRESENTATION (AGENCY))

bank customer contract....6-14

death, insanity has similar effect....44 n 33, 52 n 52, 99 n 178

definition....7-8, 11 n 17, 38 n 24

MANDATE cent.

development, low level of....7 n 6, 38 n 24, 50-1, 99 n 177

need for further development....50

lapsing on mandant's loss of capacity....37-72, 166-7

exception where mandatary is unaware of loss of capacity....41-51

scope of the exception - negative or positive interest - the mandatary's obligations....41-51, 151

lapsing is a naturale not an essentiale....51-72

lapsing of mandate and of contract of mandate distinguished....38 n 24

locatio conductio operarum, some authorities hold that mandate is if fee is stipulated....68 n 108

mandate and contract of mandate distinguished....38 n 24

mandatum solvendae pecuniae....9-10

payment under mandatum solvendae pecuniae constitutes direct discharge of debt; it does not give rise to claim which is set off against debt....15 n 25

representation (agency), distinguished from....7 n 6, 38 n 24, 99 n 177

confusion of concepts....7 n 6, 38 n 24

revocation of mandate and of contract of mandate distinguished....38 n 24

NATURALIA (NATURAL INCIDENTS) - See CONTRACT

NOTICE - See CONTRACT

OFFERS - See CONTRACT

OPTION - See CONTRACT

NEGATIVE INTEREST

a general rule that a person dealing with another in reliance on the other's continued capacity to act is entitled to be indemnified for his negative interest?....145-54

conclusions....154

NEGATIVE INTEREST cont.
a general rule etc cont.

desirability....146

good faith....153

negative interest generally exceeds unjust enrichment....146

negligence in relation to absence of knowledge....153

principal situations in which rule would apply....147-52

acceptance of offers....148-9

contracts other than mandate which lapse on a party's loss of capacity....151-2

mandates....151

notices exercising rights under contracts....149

offers....147-8

options....149

performance of obligations....149

representation....152

debtor who pays debt in ignorance of creditor's loss of capacity....94-7

mandatary who performs mandate in ignorance of mandant's loss of capacity....41-51

offeree who 'accepts' offer and performs 'obligations' in ignorance of offeror's loss of capacity....109-26

OVERDRAFT

option to borrow, grant of facility is....21, 142

withdrawal of facility....640-1

PAYMENT

capacity to receive payment....94-7

indemnification for negative interest if payer is unaware of payee's loss of capacity....94-7

payment to company is not a disposition by company....375-81

PAYMENT cont.

payment to one's creditor's creditor....130-1

payment to third party in accordance with the company's directions....381-91

payment under mandatum pecuniae solvendae - eg of cheque or other payment instruction - constitutes direct discharge of debt; it does not give rise to a claim which is set off against debt....15 n 25

set-off is a disposition....394-5

PRESCRIPTION

constitutes a disposition....450-2

debt due on demand....140 n 291

PRESENTATION OF WINDING-UP APPLICATION

commencement of winding-up deemed to have occurred on presentation only when winding-up order granted, not before....256

freezing of bank account....633-46

generally....274-302

interdict against....632

point in time at which presentation occurs....274-302

changes in s 348 from the 1928 Act....285-8

'commencement of winding-up' in other sections of the Act....291-9

conclusions....302

dictionary definition....288-9

existing judicial pronouncements....279-85

judicial management, windings-up preceded by....300-2

meaning of 'presentation' in England and elsewhere....278-9

possible points in time....276-7

'presentation' in other sections of the Act....289-91

PRODIGALITY - See TERMINATION OF BANK'S DUTY AND AUTHORITY

PROPERTY - See *DISPOSITION*

RELIANCE ON CONTINUED CAPACITY TO ACT - See NEGATIVE INTEREST

REPRESENTATION (AGENCY) (See also MANDATE)

'agency', 'representation' used in preference to....97 n 170

definition....7-8, 11 n 17, 38 n 24

development, low level of....7 n 6, 38 n 24, 50-1

lapse of power of representation on grantor's loss of capacity....38 n 24, 52, 97-108

representative and third party unaware of loss....97-108

representative unaware of loss....97-108, 152

third party unaware of loss....97-108, 152

mandate distinguished from....7 n 6, 11 n 17, 38 n 24, 99 n 177

con[illegible] of concepts....7 n 6, 38 n 24

s 23 of the Bills of Exchange Act....98 n 174

s 24 of the *Bills of Exchange Act....107 n 202*

SECTIONS 348 and 341(2) OF THE COMPANIES ACT (See also DISPOSITION, PRESENTATION OF WINDING-UP APPLICATION, VALIDATION)

'by the company', see *DISPOSITION*

comparative legislation....647-67

Australia....651-4

Canada....655-7

conclusions....667

England....648-51

France....661-3

Germany....665-7

India....654-5

Netherlands....664-5

United States....657-60

SECTIONS 348 and 341(2) OF THE COMPANIES ACT cont.

discretion, dangers in wide....236-7

extent to which s 348 backdates winding-up....255-73

absurdity if backdating is for all purposes....257

conclusions....272-3

decided cases in England and elsewhere....257-65

indications arising from the application of the Insolvency Act to windings-up....267-8

indications in other sections of the Companies Act....269

not applicable until winding-up order granted....255-6

other anomalies....271

practice in relation to commencement of windings-up....269-71

prima facie for all purposes....256

redundancy of other sections if backdating is for all purposes....266-7

foreign authority, weight to be accorded to....242-54

decisions on similar statutory provisions

in England....243-7

prior to adoption in South Africa....244-7

in other jurisdictions....247

differences in the common law and statutory contexts of ss 348 and 341(2) and their counterparts elsewhere....247-54

freezing of bank account on presentation....633-46

generally....181-2, 210-11, 226-668, 673-6

interpretation, restrictive....231-41

hardship, sections may be the source of....235-41

historical background....231, 233-5, 328-31

interference with rights....241

SECTIONS 348 and 341(2) OF THE COMPANIES ACT cont.
interpretation, restrictive cont.

mischief aimed at....231-5

'property', see DISPOSITION

repeal, desirability of....673-6

similar statutory provisions in other countries....242

'unable to pay its debts'....303-11

commercial insolvency....304-6

company's inability to pay its debts need not have been ground on which it was wound up....306

contingent debts....304-6

deemed inability to pay its debts under s 345....304-5

factual insolvency....304-6

point in time at which company must be unable to pay its debts for s 341(2) to apply....307-11

s 341(2) *only* applies to companies unable to pay their debts....303

voluntary winding-up....306

SET-OFF - See PAYMENT

STATUTES

Bills of Exchange Act 34 of 1964

s 1....174-5

s 2(1)....174-5

s 23....98 n 174

s 24....107 n 202

s 73(c)....171-83, 211-25, 669-72

Companies Act 61 of 1973

s 339....184-9, 326

s 340....326-7

s 341(2)....181-2, 210-11, 226-668, 673-6

STATUTES cont.
Companies Act 61 of 1973 cont.

s 345....303-4

s 348....181-2, 210-11, 226-668, 673-6

s 415(1)....188

Insolvency Act 24 of 1936

s 22....183-225

s 24(1)....191-2

s 135(3)(a)....177 n 44

Prescription Act 68 of 1969

s 12(1)....140 n 291

TACIT TERMS - See CONTRACT

TERMINATION OF BANK'S DUTY AND AUTHORITY (See also BANK'S DUTY AND AUTHORITY, SECTIONS 348 and 341(2) OF THE COMPANIES ACT)

bank customer contract, term that cheques and other payment instructions are fully effectual as between bank and customer until bank becomes aware of customer's loss of capacity....33-92

consequences of non-recognition of such a term

cheques and payment instructions in customer's own favour, capacity to receive payment....94-7, 129-30, 136-7, 143-4

cheques and payment instructions issued on the customer's behalf....97-109, 131-2

commencement of loss of capacity, cheques and payment instructions issued before and after distinguished....34-5

loss of capacity occurs after cheque or payment instruction is issued but before it is received by bank....132-7

customer's account in credit or overdraft facility available....132-5

customer's account not in credit and no overdraft facility available....135-7

TERMINATION OF BANK'S DUTY AND AUTHORITY cont.
bank customer contract, term that cheques etc are fully effectual etc cont.

loss of capacity occurs after cheque or payment instruction is received by the bank but before it is honoured or dishonoured....137-45

customer's account in credit or overdraft facility available....137-44

customer's account not in credit and no overdraft facility available....144-5

loss of capacity occurs before cheque or payment instruction is issued....129-132

payment to one's creditor's creditor....130-1

rights of mandatary who performs mandate in ignorance of mandant's loss of capacity....41-51

rights of offeree who 'accepts' offer and performs his 'obligations' in ignorance of the offeror's loss of capacity....*109-126, 136*

consequences of recognition of such a term

bank's duty....91-2

capacity to receive payment where cheque or payment instruction is in customer's own favour....94

generally....126-8

implied (tacit) term....80-9

is it legally possible for a cheque 'drawn' or other payment instruction 'given' after the customer's loss of capacity to function as a cheque or payment instruction?....74-6

lapse of mandates on mandant's loss of capacity....37-72, 166-7

exception where mandatary is unaware of loss....41-51

lapsing is a naturale not an essentiale of mandate....51-72

lapse of offers on offeror's loss of capacity....72-4, 167 n 20, 206-7

lapsing may be excluded by agreement....72-4

TERMINATION OF BANK'S DUTY AND AUTHORITY cont.
bank customer contract, term that cheques etc are fully effectual etc cont.

naturale of the bank customer contract....76-9, 89-91

bank customer contract, termination of distinguished from termination of bank's duty and authority....35

generally....1-2

inability to manage one's affairs - see 'insanity' below

insanity....28-160

certification....32

English, Australian, Canadian and United States law....33-6

loss of capacity on....31-3

fluctuating....32-3

partial....31-3

onus of proof....32

meaning of 'termination of bank's duty and authority'....25-6

notice of loss of capacity....154-60, 211-225

bank's position if it reasonably but wrongly concludes that customer has capacity....158

constructive notice....159-60, 216-225

the company law doctrine of....220-5

diagnosis of insanity, difficulty in....154-5

enquiry, duty to make further....156-8, 213-4

enquiries which bank can make....157-8

prodigality - see 'insanity' above

sequestration and winding-up....161-225

concursus creditorum....166-71

consequences cannot be excluded by agreement....169, 201-3

TERMINATION OF BANK'S DUTY AND AUTHORITY cont.
sequestration and winding-up cont.

consequences modified by s 73(c) of the Bills of Exchange Act and s 22 of the Insolvency Act....170-216

crystallisation of insolvent's position....168-171

not established by judicial management....166

not established if company is able to pay its debts....166-7

uncompleted contracts in general unaffected....170

English and United States law is of limited persuasive authority....168 n 25

loss of capacity on....164-5

companies, and other corporate bodies, having a registered office or place of business in South Africa....165

natural persons, partnerships, trusts, other unincorporated bodies and corporate bodies not having a registered office or place of business in South Africa....164

s 22 of the Insolvency Act....183-211

applicability to payments to third parties 195-6

applicability to windings-up....185-9

application to the bank customer relationship 196-208

payment instructions given against a credit which arose after sequestration or winding-up....199

payment instructions given against a credit which existed on sequestration or winding-up 197-8

payment instructions given outside the scope of a credit or overdraft facility....205-9

payment instructions given within the scope of an overdraft facility....199-205

TERMINATION OF BANK'S DUTY AND AUTHORITY cont.
sequestration and winding-up cont.

bank's duty....208-9

discharge of the customer from sequestration or winding-up....211

good faith....209-10

inter-relationship between s 22 and ss 348 and 341(2) of the Companies Act....210-11

meaning of 'any obligation....the cause of which arose before the sequestration'....189-90

obligations the cause of which arises after sequestration....190-5

onus of proof....211

s 73(c) of the Bills of Exchange Act....170-83

amendment, desirability of....669-72

applies to natural and artificial persons....172-4

'cheque', meaning of....174-5

cheques drawn after sequestration or winding-up....175-6

discharge of the customer from sequestration or winding-up....183

'having become insolvent', meaning of....176-7

inter-relationship between s 73(c) and ss 348 and 341(2) of the Companies Act....181-2

onus of proof....183

protection afforded by s 73(c), scope of....178-80

cheques in favour of the customer....178-9

customer's account in credit: bank's right to its charges and to set them off against credit....179

customer's account in overdraft: bank's right to prove a secured claim if it holds security....180

UNJUST ENRICHMENT....27

VALIDATION (See also DISPOSITION, PRESENTATION OF WINDING-UP APPLICATION, SECTIONS 348 and 341(2) OF THE COMPANIES ACT)

advance and ex post facto validation....479-86

are the criteria the same for advance and ex post facto validation?....485-6, see further 'criteria for validation' below

can a validation order be granted either in advance or ex post facto?....479-85

sense in which 'ex post facto' is used....479 n 1

bank account, continued operation of....582-613

advance applications....602-3

Anhadra Bank Ltd v Narayana Rao....596-7

Clifton Place Garage Ltd, In re....597-600

dispositions involved in the operation of a bank account....600-2

ex post facto applications

account in credit....604-5

deposits....604

withdrawals....604-5

account in overdraft....605-10

deposits....605-6

security....605-10

withdrawals....606-8

bank charges....610-13

Gray's Inn Construction Co Ltd, Re....583-92

International Life Assurance Society Gibbs and West's Case, In re....593

Millar v The National Bank of Scotland Ltd....593-5

onus on bank to ensure that safeguards set out below are instituted?....501-2, 522 n 19, 586-8, 608

VALIDATION cont.
bank account, continued operation of cont.

safeguards to ensure that:

preferential payments are not made....501-2, 586-8, 608

continued trading is beneficial....522 n 19, 586-8, 608

payment instructions are only given in the ordinary course of the company's business....586-8, 608

T W Construction Co Ltd, Re....595-6

criteria for validation....494-613

applicant for winding-up, disponee was....576-7

avoidance of paralysis of the company's business, see 'ordinary course of business' below

benefit of the interested parties....514-25

advance applications....517-23

conflicting interests must be weighed....514-5

ex post facto applications....523-5

illustrations of beneficial transactions....515-7

onus on bank to ensure that continued trading is beneficial?....522 n 11, 586-8

cancellation, threat of....566-9

compassion for the disponee....562-3

comprehensive enumeration not possible....494-7

conclusions....577-82

advance applications....578-9

ex post facto applications....580-2

dilatory tactics on the part of the company prior to presentation....576

dissipation of company's assets, see 'object of s 341(2)' below

enriched, company should not be....565-6

VALIDATION cont.
criteria for validation cont.

fairness towards the disponee, see 'justice and fairness towards the disponee' below

good faith....526-45

advance applications....531-2

ex post facto applications....532-45

good faith on the part of the company....532-3

good faith on the part of the disponee....538-45

insolvency law position, assimilation to....563-4

justice and fairness towards the disponee....554-62

conclusions....561-2

conclusion of a contract....555-7

discharge of an obligation....557-60

series of transactions....560-1

knowledge that company is in financial difficulties....536-41

knowledge of presentation of winding-up application....536-41

knowledge that disposition was not in interests of creditors....533-6

legal action, threat of....573-4

motive to benefit creditors or the company....541-5

object of s 341(2)....497-514

avoidance of dissipation of the company's assets....499

concurrent creditors should benefit pari passu 499-514

onus on bank to ensure that preferential payments are not made?....501-2, 586-8, 608

pre-presentation debts....502-7

VALIDATION cont.
criteria for validation cont.

post-presentation debts....507-14

objection, none from interested parties....574

ordinary course of business....545-54

advance applications....548

ex post facto applications....549-54

object of test is avoidance of paralysis of company's business....549-51

test is unlikely to achieve this object....551-4

onus on bank to ensure that payment instructions are only given in the ordinary course of the company's business?....586

pari passu distribution, see 'object of s 341(2)' above

past consideration not sufficient....574-5

practical interpretation....575

preceding circumstances....575-6

preference, intention to give or get....500-1

pressure by disponee....566-74

threat of cancellation....566-9

threat of legal action....573-4

threat of refusal to enter into further transactions....569-73

positive benefit to company not necessary....565

refusal to enter into further transactions....569-73

settlement, acceptance of reduced payment in....576

urgency, decision taken as a matter of....566

discretion, scope of court's....493-4

'disposition'....486-92, see also DISPOSITION

validation of part of a disposition....490-2

VALIDATION cont.
'disposition' cont.

validation of post-winding-up dispositions....486-8

validation of dispositions generally eg continued conduct of business....488-90

ex post facto validation, see 'advance and ex post facto validation' above

factors relevant to exercise of court's discretion, see 'criteria for validation' above

generally....468-631

non-validation, consequences of....624-31

directors, personal liability....630-1

loan, recovery of monies advanced....629

mora interest....630

s 32 of the Insolvency Act....625-6

security, release of....629

suretyships....627-8

third party, recovery from bona fide....626

procedure to obtain validation order....614-23

action or application....615

advance validation....615-6

ex post facto validation....616

appropriate court....614

costs....622-3

degree of proof....621-2

joinder....615

locus standi....616-9

onus....619-21

two parties liable to restore disposition, release of one only....49

WINDING-UP - See TERMINATION OF BANK'S DUTY AND AUTHORITY



Author Douglas Kenneth John
Name of thesis The termination of the duty and authority of a bank to honour its customer's cheques and other instructions for payment, including the broader implications for a bank of Sections 341(2) and 348 of the Companies Act 1973. 1985

PUBLISHER:
University of the Witwatersrand, Johannesburg
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