

INSOLVENCY CLAUSE IN AN INTERNATIONAL COMMERCIAL AGREEMENT – THE POSITION IN SOUTH AFRICA

INTRODUCTION

Is the clause valid and enforceable in South Africa?

OPINION

Uncompleted contracts¹ are dealt with under both the Insolvency Act² and the common law. Under the common law, sequestration or liquidation automatically terminates certain contracts or agreements (for example a partnership³), whereas other contracts in force on the date of institution of the *concursum creditorum* are not terminated by the insolvency or liquidation of a party thereto.⁴

The question will be whether the cancellation clause as mentioned above will be enforceable on the trustee or liquidator of the insolvent estate.⁵

The common law rule is that the contract remains in force, with the trustee or liquidator having to take it as he finds it, and the effect of the institution of the *concursum* is that the other party to the contract cannot compel the trustee or liquidator to specific performance.⁶

If, therefore, in terms of the contract, the other party thereto has prior to sequestration or liquidation acquired the right to cancel, the trustee or liquidator is unable effectively to resist the exercise of such right.⁷ However, any provision⁸ designed to protect one party's interest in the event of insolvency is void in relation to the trustee or liquidator if it purports to alter the legal consequences of the *concursum creditorum*.^{9,10}

The test in each case will be whether the provision seeks to confer a preference or right which is not provided for by the law of insolvency.¹¹ To the extent that a cancellation clause allows for termination of an agreement on the basis of insolvency alone it would seem to be unenforceable. This view is further reinforced by section 37(5) of the Insolvency Act.¹²

Due to the fact that South African Insolvency Law is based on a 'creditor-friendly' system and philosophy and the general principle of *concursum creditorum*, it is doubtful whether any alternative clause or provision, which will have a similar effect of protecting the rights of one of

¹ See Smith *Insolvency Law* (1988) 3rd edition; Kunst et al Meskin, *Insolvency Law and its Operation in Winding-up* (loose-leaf edition, issue 19).

² Act 24 of 1936.

³ See Kunst et al Meskin, *Insolvency Law and its Operation in Winding-up* (loose-leaf edition, issue 19)

⁴ Thus for example a service contract in terms of the new section 38 of the Insolvency Act provides for the initial suspension of the obligations between an insolvent employer and its employees in terms of their contracts of service. See also Evans *New developments in insolvency and contracts of employment* 2000 SA Merc LJ 408 for a discussion of these initial proposals; Bosch C *A survey of the 2002 Labour Relations Amendments: Is there really something for everyone?* 2003 ILJ 23 610. Cf Van Eck and Boraine *Voluntary winding-up of a company and dismissals in terms of the Labour Relations Act* 2002 THRHR 610.

⁵ *Bryant and Flanagan (Pty) Ltd v Muller and Another NNO* 1977 (1) SA 800 (N).

⁶ *Thomas Construction (Pty) Ltd (in liquidation) v Grafton Furniture Manufacturers (Pty) Ltd* 1988 (2) SA 546 (AD).

⁷ *Smith and Another v Parton NO* 1980 (3) SA 724 (D) at 729–730.

⁸ Other than a right to cancel which accrued prior to sequestration or liquidation.

⁹ See Swart *Die Rol van 'n Concursum Creditorum in Suid Afrikaanse Insolvensiereg* (1990 LLD dissertation UP).

¹⁰ Hockley et al *Insolvency Law* (7th Ed) 81.

¹¹ See *Thorne & another v the Government* 1973 (4) SA (T).

¹² For the termination of credit agreements in terms of the National Credit Act 24 of 2005 see s 121- 123.

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the party's to the agreement or contract in the instance of insolvency of the other party, would be enforceable.

CONCLUSION

The clause is not valid and enforceable in South Africa. By virtue of what I have set out above, no valid and enforceable alternative can be put forward as such a clause will be void.

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