THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

REPORTABLE

Case No: 245/13

In the matter between:

ELLERINE BROTHERS (PTY) LTD **APPELLANT**

and

McCARTHY LIMITED **RESPONDENT**

Neutral citation: *Ellerine Bros v McCarthy* (245/13) [2014] ZASCA 46 (1 April 2014)

Coram: Navsa, Mhlantla, Leach, Petse JJA and Van Zyl AJA

Heard: **19 March 2014**

Delivered: **1 April 2014**

Summary: Insolvency – s 348 of the Companies Act – commencement of winding-up – lessor giving insolvent lessee written notice to cure breach as required by contract – insolvent failing to do so – lessor cancelling the contract after the commencement of winding-up – right to cancel the contract not lost – cancellation of the contract valid.

ORDER

On appeal from: North Gauteng High Court, Pretoria (De Vos J sitting as court of first instance):

The appeal is dismissed with costs, including the costs of two counsel.

JUDGMENT

Van Zyl AJA (Navsa, Mhlantla, Leach and Petse JJA concurring)

[1] The appeal concerns the validity of a cancellation of a lease agreement. The problem presenting itself is the following: Notice of cancellation was given before the commencement of legal proceedings for the winding-up of the lessee, but the period provided for had not yet expired when those proceedings commenced and cancellation followed thereafter. Put simply, the question is whether the right to cancel was lost because of a *concursus creditorum*. This issue was placed before the high court for decision pursuant to an agreement between the parties that it be decided on an agreed statement of facts as envisaged in rule 33 of the Uniform Rules of Court. The high court decided the issue in favour of the respondent and dismissed the appellant's claims with costs. The appeal is with the leave of the high court.

[2] The agreed facts are the following. In 2006 the appellant, Ellerine Brothers (Pty) Ltd (Ellerine), concluded a lease agreement with a company called Toits Motor Group (Pty) Ltd (the insolvent) in terms of which it let to it certain business premises.

In the same year the insolvent entered into a sub-lease agreement with the respondent, McCarthy Limited (McCarthy) in respect of a portion of the property. The events which follow took place in 2009. The insolvent failed to timeously pay the agreed rental. Ellerine notified it in writing on 16 January that should it fail to remedy its breach of the lease within seven days of receipt of the letter, Ellerine would take steps to cancel the agreement. The letter was received by the insolvent on the same day.

[3] The insolvent did not comply with this demand. On 27 January Ellerine delivered a letter cancelling the lease with immediate effect. Shortly before this, on 21 January, an application for the liquidation of the insolvent had been lodged by a creditor with the registrar of the high court. The application was enrolled for hearing on 27 January but was postponed to 27 February for the filing of answering and replying affidavits. On the latter date a final order was issued for the winding-up of the insolvent.

[4] In June, Ellerine and the liquidators of the insolvent entered into a cession agreement. As consideration for the rental payable by the insolvent to Ellerine under the lease, the liquidator ceded to Ellerine the insolvent's rights to the rental payable by McCarthy under the sub-lease. It was recorded in the deed of cession that the lease was still in existence; that Ellerine was not entitled to cancel the lease from the date of the presentation to court of the application for the liquidation of the insolvent, and that the liquidator had exercised an election to continue the lease.

[5] In October, relying on the cession Ellerine issued summons against McCarthy in the high court claiming the rental and other amounts allegedly due in terms of the sub-lease. McCarthy denied liability for the amounts claimed and defended the action. At the hearing of the matter the parties agreed that the only issue in dispute was whether Ellerine could validly cancel the lease after the commencement of the proceedings for the winding-up of the insolvent. The high court was asked to determine this issue on the stated case. The legal submissions of the parties

recorded in the statement of agreed facts were premised on their pleadings. In its plea, McCarthy did not place the existence of the cession agreement in dispute. Instead, it alleged that the sub-lease was terminated when Ellerine, on 27 January, advised the insolvent that it had elected to cancel the lease, and that there were no rights in existence which the liquidator could cede to it. McCarthy's defence is consistent with the legal nature of a sub-lease.[1] As the sub-lessee's rights to the leased property are subject to those of the lessee, determination of the lease ipso jure also brings the sub-lease to an end.[2] Put differently, a sub-lessee cannot acquire more rights from the lessee than what the lessee himself has.

[6] Ellerine's response in its replication was that by reason of the winding-up of the insolvent, it could not validly cancel the lease when it purported to do so on 27 January. This contention has as its basis the provisions of s 348 of the Companies Act 61of 1973.[3] It reads as follows:

'A winding-up of a company by the Court shall be deemed to commence at the time of the presentation to the Court of the application for the winding-up.'

An application for the winding-up of a company is presented to the court when it is lodged with the registrar.[4] In this matter that date was 21 January 2009. The case advanced by Ellerine in this court and in the high court was in essence that as a result of the retroactive commencement of the insolvent's liquidation the right of Ellerine as the sub-lessor to cancel the lease had been lost. It was submitted that the estate of the insolvent had been frozen on 21 January when an application for the liquidation of the insolvent was lodged with the registrar.

---

[1] *Sewpersadh v Dookie* 2009 (6) SA 611 (SCA).
[2] *Ntai & others v Vereeniging Town Council & another* 1953 (4) SA 579 (A) at 589A-B.
[3] As a transitional arrangement, in terms of para 9(1) of Schedule 5 of the new Companies Act 71 of 2008, the provisions of Act 61 of 1973 continue to apply with respect to the winding-up and liquidation of companies until a date determined by the relevant Minister.
[4] J A Kunst, P Delport and Q Vorster *Henochsberg on the Companies Act* (Vol 1, 5 ed) at 740(1) and the authorities referred to.

[7] This contention is premised on the creation of a *concursus creditorum* on that date.[5] The argument is that the *concursus* interposed between the giving of notice on 16 January and the expiry of the seven day period therein. The interruption of the required time period by the *concursus* prevented Ellerine from claiming any further performance from the lessee under the lease until the liquidator had elected to abide by the lease. This meant that a condition for the existence of its right to cancel the lease remained unfulfilled. Relying on the decisions in *De Wet NO v Uys NO & andere* and *Roering NNO & others NNO v Nedbank Ltd*[6] it was argued that in the absence of a right to cancel which accrued before the *concursus*, Ellerine could not validly cancel the lease. This, it was contended, meant that the sub-lease remained in force and the liquidator was entitled after his appointment to cede his right and title in the sub-lease to Ellerine.

[8] Furthermore, Ellerine submitted that the provisions of s 37 of the Insolvency Act 24 of 1936 (the Insolvency Act), which applies to the winding-up of a company, supported its case.[7] The relevant sub-sections provide:

'(1) A lease entered into by any person as lessee shall not be determined by the sequestration of his estate, but the trustee of his insolvent estate may determine the lease by notice in writing to the lessor: Provided that the lessor may claim from the estate, compensation for any loss which he may have sustained by reason of the non-performance of the terms of such lease.

(2) If the trustee does not, within three months of his appointment notify the lessor that he desires to continue the lease on behalf of the estate, he shall be deemed to have determined the lease at the end of such three months.

(3) The rent due under any such lease, from the date of the sequestration of the estate of the lessee to the determination or the cession thereof by the trustee, shall be included in the costs of sequestration.'

---

[5] *Thomas Construction (Pty) Ltd (in liquidation) v Grafton Furniture Manufacturers (Pty) Ltd* 1988 (2) SA 546 (A) at 566H.
[6] See *De Wet NO v Uys NO & andere* 1998 (4) SA 694 (T) at 698I; *Roering NNO & others NNO v Nedbank Ltd* 2013 (3) SA 160 (GSJ) at 164E-H.
[7] Section 339 read with s 386(4)*(g)* of the 1973 Companies Act.

It was contended that the effect of s 37 is to create a right for the liquidator to end the lease. That being the position, the liquidator must be given time to decide whether to exercise that right. Should the lessor be permitted to cancel the lease, it would negate the liquidator's right to elect to either terminate or continue the lease.

[9] The high court (per De Vos J) found that the lease was validly cancelled and that the provisions of s 37 of the Insolvency Act did not find application. It appears to have arrived at this conclusion on the basis that Ellerine acquired the right to cancel the lease when, in compliance with clause 20.1 of the lease, it gave the insolvent written notice on 16 January to remedy its breach of the agreement and the insolvent failed to comply therewith. Clause 20.1 is a *lex commissoria*. It provided that if the lessee failed to pay the rental '. . . and continues that failure for more than 7 (seven) days after receipt of a notice demanding payment . . . then the lessor shall have the right, but shall not be obliged, forthwith to cancel this agreement . . . .' The importance of this clause, in the context of a lease agreement, is that in the absence thereof a lessor cannot cancel the lease unless it has first placed the lessee in *mora*.[8] Clause 20.1 was solely for the benefit of Ellerine. It reserved the right to cancel the lease upon the fulfilment of a condition, namely the failure of the lessee to comply with the notice within the required time period. The letter of 16 January was clearly written in compliance with this clause. Its purpose was to enable Ellerine to bring the lease to an end should the rental not be paid within seven days.

[10] The conclusion arrived at by the high court is correct. The arguments advanced by Ellerine lose sight of the effect, or rather the lack thereof, that the insolvency of the lessee has on a lease. Following on the insolvency of the lessee the position is governed by the ordinary principles of the common law which apply when a party to an executory contract goes insolvent.[9] As in the case of any other uncompleted contract, the liquidator inherits the lease in its entirety. The creation of the *concursus creditorum* therefore does not terminate the continuous operation of a

[8] *Spies v Lombard* 1950 (3) SA 469 (A) at 487A-C; *Goldberg v Buytendag Boerdery Beleggins (Edms) Bpk* 1980 (4) SA 775 (A) at 793 (C); *Nel v Cloete* 1972 (2) SA 150 (A).
[9] *Norex Industrial Properties (Pty) Ltd v Monarch SA Insurance Co Ltd* 1987 (1) SA 827 (A) at 838H-I.

lease agreement to which the insolvent is a party.[10] The *concursus* neither alters nor suspends the rights and obligations of the parties thereunder and the liquidator, as the universal successor, steps into the shoes of the insolvent and does not acquire any rights greater than those of the insolvent.[11] This means that the liquidator must perform whatever is required of the insolvent in terms of the lease, including unfulfilled past obligations of the lessee.[12]

[11] The intended aim of the *concursus*, or as it has also been described, the 'community of creditors',[13] created immediately upon the liquidation of the insolvent, is to give equal protection to all the creditors without undue preference and to preserve and distribute the estate to the benefit of all of them.[14] To give effect to the *concursus*, the liquidator must decide whether it would be to the benefit of the community of creditors to continue to perform the inherited obligations of the insolvent under an uncompleted contract. He may elect not to do so. In that event a consequence of the *concursus* is that the other party to the contract cannot demand performance by the liquidator of the insolvent's contractual obligations. The statement, 'frequently encountered, that a trustee or a liquidator in insolvency has a "right of election" whether or not to abide by a contract' means no more than that by reason of the existence of the *concursus* 'the other party cannot exact specific performance against the trustee or liquidator if the latter should decide to abandon the contract'.[15] The act of the liquidator in deciding not to continue the lease constitutes '. . . a repudiation of the contract, which would have afforded the lessor . . . the right, concurrently with other creditors, to claim from the liquidator the payment of damages for the non-performance by the company of its contractual obligations'.[16] The claims of the other contractant are therefore reduced by the *concursus* to a monetary claim and participation in the insolvent estate as a concurrent creditor, where it is treated on the same basis as all the other creditors in the insolvent estate.

---

[10] *Norex Industrial Properties* above at 838H-I.
[11] *Thomas Construction (Pty) Ltd (in liquidation) v Grafton Furniture Manufacturers (Pty) Ltd* above at 568C.
[12] *Goodricke & Son v Auto Protection Insurance Co Ltd (in liquidation)* 1968 (1) SA 717 (A) at 723G; *Bryant & Flanagan v Muller & another NNO* 1978 (2) SA 807 (A) at 812H-813B.
[13] *Richter NO v Riverside Estates (Pty) Ltd* 1946 OPD 209 at 223.
[14] *Ward v Barrett NO & another NO* 1963 (2) SA 546 (A) at 552.
[15] *Thomas Construction* above at 566J-567A.
[16] Per Botha JA in *Norex Industrial Properties* above at 838J-839A-B.

[12] As stated in *Smith & another v Parton NO*,[17] there is 'really only one legal principle involved and that is that there is nothing in the law of insolvency which affects uncompleted contracts in general; the contract is neither terminated nor modified nor in any way altered by the insolvency of one of the parties (cf *Uys & another* 1998 (4) SA 694 (T)) except in one respect, and that is that, because of the supervening *concursus*, the trustee cannot be compelled to perform the contract'.[18] The existence of the *concursus*, does not, on this principle, in any way affect the continued existence of the rights and obligations of the respective parties to an uncompleted contract. There is accordingly nothing, as Galgut AJ correctly found in *Porteous v Strydom NO*,[19] that 'excuses the trustee from performing the insolvent's obligations which fall due to be performed between the date of sequestration and the date upon which the trustee makes his election' to abide the contract.

[13] It follows that there is no merit in the appellant's suggestion that the demand for payment in the letter of 16 January offended against the *concursus* because it constituted a claim for specific performance, nor that payment of the amount demanded would have meant that one creditor was preferred over another. As stated in *Porteous* 'after the *concursus* occurs, the trustee steps into the shoes of the insolvent, and the trustee is then obliged to perform whatever is required of the insolvent in terms of the contract, including unfulfilled past obligations of the insolvent'.[20] It is only in the event of the liquidator making an election not to abide by the uncompleted contract that the lessor, because of the *concursus*, cannot compel performance. Absent such an election, the terms of the lease remain in place and the liquidator must comply with it.

[14] Turning to the relevant provisions of s 37 of the Insolvency Act quoted earlier, its effect must be assessed against the background of the position under the common law. The reason is that the Insolvency Act is not a codification of the

[17] Per Friedman J in *Smith & another v Parton NO* 1980 (3) SA 724 (D) at 728H-729A.
[18] See also *Estate Friedman v Katzeff* 1924 WLD 298 at 302; *Mitchell v Sotiralis's Trustee* 1936 TPD 252 at 254 and *Tangney & others v Zive's Trustee* 1961 (1) SA 449 (W) at 452-453.
[19] *Porteous v Strydom NO* 1984 (2) SA 489 (D) at 494G-H.
[20] *Porteous v Strydom NO* above at 494F.

common law of insolvency.[21] It follows that save to the extent that it may have been changed by the Insolvency Act, or is inconsistent with it, the common law still finds application. The provisions of s 37(1) to (3) are substantially no different from the common law position sketched earlier, and do not otherwise confer any rights and obligations on the lessor or the liquidator which are inconsistent with the position under the common law. The insolvency of the lessee therefore does not terminate the lease. The liquidator may, however, elect not to continue the lease in which event s 37(1) authorises him to determine it. Should he decide to do so, s 37(1) requires the liquidator to notify the lessor of his decision in writing. At common law the liquidator has to give reasonable notice of his intention to continue the contract, otherwise the other party may treat the contract at an end.[22] Section 37(2), however, requires the liquidator to notify the lessor of his desire to continue the lease within three months, failing which he shall be deemed to have determined the lease. Although the liquidator's authority to determine the lease is derived from s 37(1), it is consistent with the election of the liquidator at common law not to perform uncompleted contracts where it may not be to the benefit of the *concursus*. The proviso to that subsection in turn preserves the lessor's right to claim compensation flowing from the liquidator's decision to prematurely terminate the lease.[23]

[15] Section 37 therefore does not materially change the common law position and none of its provisions prevent the lessor from exercising a right to cancel which became enforceable after the *concursus*. I should mention that in this context it is unhelpful to speak of an 'accrued right to cancel' which survives the establishment of the *concursus* or of a right to cancel which only matures after the commencement of the winding-up (as has been done in certain cases). The issue is simply whether there was an effective and enforceable right at the critical time – the time of the cancellation. In this case, Ellerine had such a right and its cancellation was valid. The conclusion reached in both *Smith & another v Parton NO* and *Porteous v Strydom NO* are to be preferred to those relied upon in support of Ellerine's present argument.

---

[21] *Fey NO and Whiteford NO v Serfontein & another* 1993 (2) SA 605 (A) at 613A-F; *Millman NO v Twiggs & another* 1995 (3) SA 674 (A) at 679H-680A.
[22] *Du Plessis & another NNO v Rolfes Ltd* 1997 (2) SA 354 (A) at 363G.
[23] *Norex Industrial Properties* above at 839I-J.

[16] In the result the appeal is dismissed with costs, including the costs of two counsel.

_____

D van Zyl

Acting Judge of Appeal

APPEARANCES

For Appellant:	S du Toit SC (with him M A Jonker)
	Instructed by:
	Gideon Pretorius Inc, Cresta
	Symington & De Kok, Bloemfontein
For Respondent:	K J Kemp SC (with him L K Olsen)
	Instructed by:
	Cox Yeats, Durban
	McIntyre & Van der Post, Bloemfontein