

Sequestration: What It Means and How It Works

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INTRODUCTION

Sequestration refers to a legal process by which a debtor's estate is declared insolvent and placed under the control of a trustee. The primary purpose of sequestration is to protect the rights and interests of creditors while offering the debtor an opportunity to resolve their financial obligations.

WHAT IS INSOLVENCY?

The legal test for insolvency is whether a debtor's liabilities, fairly estimated, exceeded the debtor's assets fairly valued.¹ A debtor's inability to pay his/her/its debts is evidence of the debtor's insolvency. For a debtor's estate to be sequestrated, his/her/its liabilities must exceed his/her/its assets (i.e. the debtor must be factually insolvent).²

WHAT CAN BE SEQUESTERED?

The Insolvency Act 24 of 1936 ("**the Act**") defines a 'debtor', for purposes of the Act, as including a natural person, partnership or the estate of a natural person or partnership but excludes, a company, close corporation or other juristic entity that may be wound up under the Companies Act 61 of 1973 ("**the Old Companies Act**").³ The courts have held that trusts and juristic entities which cannot be wound up under the Old Companies Act are also 'debtors' for purposes of the Act.⁴ Accordingly, natural persons, partnerships (or their estates), trusts and juristic entities that cannot be wound up under the Old Companies Act, can be sequestrated.

ACTS OF INSOLVENCY

According to the Act⁵ a debtor can be deemed to commit an act of insolvency if, amongst others, the debtor:

- Leaves or attempts to leave the Republic with the intention of evading or delaying the payment of debts;
- Fails or is unable to satisfy the execution of a court judgment;

- Disposes of assets with the effect of prejudicing creditors or preferring one creditor over another;
- Removes or conceals assets with the intent to prejudice creditors or prefer one creditor over another;
- Offers to make a compromise/arrangement with any creditor that has the effect of releasing the debtor from his/her/its debts, either partially or fully;
- After publishing a notice of surrender in terms of section 4(1) of the Insolvency Act (which has not lapsed or been withdrawn), fails to lodge a statement of affairs with the Master of the High Court ("the Master"), files a materially incorrect or incomplete statement of affairs, or fails to apply for acceptance of the surrender on the date specified for the surrender to take place;
- Notifies any creditor in writing that he/she/it is unable to pay his/her/its debts;
- After having published a notice to transfer its business, in terms of section 24(1) of the Act, is thereafter unable to pay all its debts.

VOLUNTARY SEQUESTRATION VERSUS COMPULSORY SEQUESTRATION

Primarily there are two types of sequestration proceedings. Voluntary sequestration / surrender is when the debtor applies to court for the voluntary surrender of his/her/its estate. In contrast, compulsory sequestration is initiated by one or more creditors who apply to court for a sequestration order against the debtor's estate.⁶

In either event, a sequestration order is issued by the court, and the debtor may be declared insolvent.

EFFECTS OF SEQUESTRATION

Once a sequestration order is granted:

- The insolvent loses control of his/her/its estate. The assets firstly vest in the Master and later in a trustee appointed to administer the estate.
- All civil proceedings against the insolvent are stayed. Creditors must lodge their claims with the trustee.

- If the insolvent is an employer, employment contracts are suspended from the date of sequestration.
- Existing contracts remain valid, but the insolvent may not dispose of estate assets or enter into further agreements without the trustee's written consent.
- If the insolvent is married out of community of property, the solvent spouse's property vests in the trustee. However, the solvent spouse may reclaim their assets by proving ownership.⁷

PROPERTY EXEMPT FROM THE INSOLVENT ESTATE

Certain assets may not be included in the insolvent estate, such as:

- Pension benefits;
- Basic necessities, including clothing, bedding and essential household items;
- Compensation for personal injury or defamation, whether received before or after sequestration;
- Remuneration from employment or professional services which may be recovered after sequestration of the estate;⁸
- Unemployment benefits payable to an employee under section 33 of the Unemployment Insurance Act 63 of 2001;
- Insurance policy benefits under section 63 of the Long Term Insurance Act 52 of 1998;
- The credit amount in the trust account of an estate agent who has been sequestrated;⁹ and
- Compensation received in terms of section 32(1) of the Compensation for Occupational Injuries and Diseases Act 130 of 1993.

REHABILITATION

The end stage of sequestration is rehabilitation, which restores an insolvent's legal status and discharges his/her/its debts. The insolvent may apply to court for rehabilitation or it may occur automatically after ten years, unless the court orders otherwise before this period elapses.¹⁰

CONCLUSION

Sequestration balances the interests of creditors and debtors. Although the debtor is placed under financial supervision, it provides a mechanism for the debtor to settle his/her/its debts and rebuild financial stability. Although sequestration sounds like the perfect aid for a debtor drowning in financial struggle, it is advised to consult a legal or financial professional for guidance.

Kindly contact the authors of this article on 011 568 8500 for more information.

¹Venter v Volkskas Ltd 1973 (3) SA 175 (T) 179

²Steyn v Steyn NO and Others 2024 (4) SA 285 (GP) 289

³Notwithstanding the repeal of the Old Companies Act under section 224 of the Companies Act 71 of 2008 (the "Companies Act"), the provisions of Chapter XIV (sections 337 to 343) of the Old Companies Act remain operative in respect of the winding up of insolvent companies, in terms of item 9 of Schedule 5 to the Companies Act

⁴Magnum Financial Holdings (Pty) Ltd (in Liquidation) v Summerly & Another NNO 1984 (1) SA 160 (W) 163; and Lawclaims (Pty) Ltd v Rea Shipping Co SA: Schiffscommerz Aussenhandelsbetrieb Der VVB Schiffbau Intervening 1979 (4) SA 745 (N) 751

⁵Section 8 of the Insolvency Act

⁶A, Smith. Hockly's Law of Insolvency, Winding-Up and Business Rescue, Juta & Company, Limited, 2022. ProQuest Ebook Central, <http://ebookcentral.proquest.com/lib/unisa1-ebooks/detail.action?docID=30400774>, part 2

⁷A, Smith, supra note 5, part 3

⁸Ibid

⁹RG Evans, Legislative exclusions or exemptions of property from the insolvent estate, January 2011, https://scielo.org.za/scielo.php?script=sci_arttext&pid=S1727-37812011000500003#:~:text=2.7%20Unemployment%20insurance%20benefits,accordance%20with%20the%20proposed%20formula.&text=While%20very%20few%20debtors%20will,primarily%20by%20the%20Insolvency%20Act

¹⁰A, Smith. supra note 5, part 6



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