

**A CRITICAL ANALYSIS OF THE EFFECT OF BUSINESS RESCUE ON THE  
LIABILITY OF SURETIES**

by

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“A CRITICAL ANALYSIS OF THE EFFECT OF BUSINESS RESCUE ON THE LIABILITY OF SURETIES”

I declare that the above dissertation/thesis is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

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SIGNATURE

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DATE

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## LIST OF ABBREVIATIONS

A	Appellate Division
AD	South African Law Reports, Appellate Division
All SA	All South African Law Reports
C	Cape Provincial Division
CIPC	Companies and Intellectual Property Commission
D	Durban & Coast Local Division
FB	Free State High Court, Bloemfontein
GNP	North Gauteng High Court, Pretoria
GSJ	South Gauteng High Court, Johannesburg
JOL	Judgments on line law report service
KDZ	KwaZulu-Natal High Court, Durban
KZP	KwaZulu-Natal High Court, Pietermaritzburg
PELJ	Potchefstroom Electronic Law Journal
SA Merc LJ	South African Mercantile Law Journal
SALJ	South African Law Journal
SC	Cape Supreme Court Reports
SCA	Supreme Court of Appeal
Searle	Searle's Reports Cape Supreme Court
THRHR	Tydskrif vir die Hedendaagse Romeins-Hollandse Reg
TPD	Transvaal Provincial Division
TSAR	Tydskrif vir die Suid-Afrikaanse Reg
WCC	Western Cape High Court, Cape Town
ZAGPPHC	South Gauteng High Court, Johannesburg
ZASCA	Supreme Court of Appeal of South Africa
ZAWCHC	Western Cape High Court, Cape Town
ZAWHC	North West High Court, Mafikeng

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## CHAPTER 1

### GENERAL INTRODUCTION

#### 1.1 Background information and problem statement

The current Companies Act<sup>1</sup> (the Act) which replaced the previous Companies Act 61 of 1973, introduced an important innovation and classification into South African law: the concept of business rescue proceedings and the administrative machinery required to implement them.<sup>2</sup>

Business rescue<sup>3</sup> is aimed at facilitating the rehabilitation of a financially distressed<sup>4</sup> company. This is achieved by first placing its supervision temporarily in the hands of a business rescue practitioner;<sup>5</sup> secondly, by imposing a temporary moratorium on the rights of claimants;<sup>6</sup> and thirdly, by developing and implementing a business rescue plan.<sup>7</sup>

Despite the introduction of the Act, the concept of 'business rescue' has given rise to too many challenges in establishing its interpretation, meaning, effect and application. One of these challenges relates to a creditor's right to enforce its claims against sureties of the company during business rescue proceedings.<sup>8</sup> Section 133 of the Act places a moratorium<sup>9</sup> on legal proceedings with the result that no legal proceedings can be instituted against the company while it is under business rescue.

The questions arising from the above are: firstly, will creditors lose their claims against sureties of the company while the company is under business rescue; and secondly, what is the effect of an adopted business rescue plan on a creditor's right to claim against sureties of the company?

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<sup>1</sup> 71 of 2008.

<sup>2</sup> Chapter 6 of the Companies Act 71 of 2008.

<sup>3</sup> Section 128(1)(b). See also Delpont *Henochsberg on the Companies Act* 443; Gribnitz & Appelbaum *Business Rescue and Compromise* 87; Delpont *The New Companies Act Manual* 141; Mongalo et al *Companies and other Business Structures* 236.

<sup>4</sup> Section 128(1)(f).

<sup>5</sup> Section 128(1)(b)(i).

<sup>6</sup> Section 128(1)(b)(ii).

<sup>7</sup> Section 128(1)(b)(iii). See also to s 128(1)(c) read together with s 150.

<sup>8</sup> Swart & Lombard (2015) 78/3 *THRHR* 521.

<sup>9</sup> The moratorium applies from the commencement of business rescue proceedings and the adoption of the business rescue plan.



In this dissertation I consider the liability of sureties during business rescue proceedings and further evaluate the impact and effect a moratorium and business rescue plan have on the liability of sureties. The application of section 154 will also be considered.

I concentrate on those business rescue provisions which deal with the liability of sureties of the companies in business rescue as in my view an overview of the entire business rescue procedure is unwarranted in this context.

## **1.2 Chapter overview**

In Chapter 2 I focus on the business rescue provisions relating to the right of the creditor to hold a surety of a company in business rescue, liable. I further examine the effect of an adopted business rescue plan on a creditor's claim against sureties of the company. The moratorium in section 133 of the Act is evaluated to determine whether sureties also benefit from its protection once a company has failed to meet its obligations. Emphasis is also placed on the legal position before and after the adoption of the business rescue plan.

In Chapter 3 I evaluate the legal position of sureties as far as it is relevant to the issues discussed in the preceding chapter(s) regarding business rescue. Specific attention is paid to issues such as the accessory nature of sureties, and the surety's right of recourse.

Chapter 4, 'Concluding Remarks and Recommendations', presents my findings and concludes with suggestions and recommendations.

## CHAPTER 2

### BUSINESS RESCUE AND ITS EFFECT ON THE LIABILITY OF SURETIES WITH REFERENCE TO LEGISLATION AND CASE LAW

#### 2.1 Introduction

Chapter 6 of the Act has introduced a new corporate rescue regime termed 'business rescue proceedings' into South Africa law to provide an effective method by which a financially distressed company can be rescued while balancing the rights and interest of all relevant stakeholders.<sup>10</sup>

The prerequisites for the initiation of business rescue proceedings are that the company must be financially distressed,<sup>11</sup> and there must appear to be a reasonable prospect of rescuing it.<sup>12</sup> A company is considered financially distressed if it appears that it is unlikely to be able to pay all of its debts as they fall due and payable within the next six months, or if it appears that the company is reasonably likely to become insolvent within the next six months.<sup>13</sup> Business rescue has the unique consequence that it places a general moratorium on any legal proceedings or executions against the company, or in relation to any property owned by the company.<sup>14</sup> This means that

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<sup>10</sup> Chapter 6 of the Act being ss 128-155 read with s 7(k).

<sup>11</sup> Section 129(1)(a). See also Loubser (part 1) 2010 *TSAR* 502.

<sup>12</sup> Section 129(1)(b). See also Loubser (part 1) 2010 *TSAR* 502; Gribnitz & Appelbaum *Business Rescue and Compromise* 90; Delpont *Henochsberg on the Companies Act* 443 & 456; Mongalo et al *Companies and other Business Structures* 236; <http://www.business-rescue.co.za/legislation/Section-129-Company-resolution-to-begin-business-rescue-proceedings.php#.Vz1oTelf2M8>. For case law dealing with the interpretation of reasonable prospect of rescuing the company refer to *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd* 2012 (2) SA 423 (WCC); *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 and Another* 2013 (1) SA 542 (FS); *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* 2013 (4) SA 539 (SCA); *Koen v Wedgewood Village Golf and Country Estate (Pty) Ltd* 2012 (2) SA 378 (WCC); *Zoneska Investments (Pty) Ltd t/a Bonatla Properties (Pty) Ltd v Midnight Storm Investments 386 Ltd* 2012 (4) All SA 590 (WCC); *Swart v Beagles Run Investments 25 Pty Ltd* 2011 (5) SA 422 (GNP).

<sup>13</sup> Section 128(1)(f)(i) and (ii). See also Cassim et al *Contemporary Company Law* 784; Loubser (2008) 20/3 *SA Merc LJ* 381; Loubser (part 1) 2010 *TSAR* 502; Rushworth 2010 *Acta Juridica* 377; Gribnitz & Appelbaum *Business Rescue and Compromise* 89; Delpont *Henochsberg on the Companies Act* 443; Wassman 2014 *De Rebus* 36; Cassim et al *Business Structures* 460; Mongalo et al *Companies and other Business Structures* 237.

<sup>14</sup> Section 133(1). See also Loubser (part 2) 2010 *TSAR* 689; Delpont *The New Companies Act Manual* 149; Van Rooyen N "The impact of business rescue proceedings on sureties" available at <http://www.barnardinc.co.za/index.php/articles/20-articles/108-the-impact-of-business-rescue-proceedings-on-sureties> (accessed 19 May 216).

no legal proceedings may be commenced or continued without either the written consent of the business rescue practitioner,<sup>15</sup> or leave of a court.<sup>16</sup>

In the course of business rescue proceedings neither a guarantee nor a surety given by a company in favour of any other person may be enforced against the company.<sup>17</sup> The only exception to this is if enforcement takes place with leave of a court and in conformity with any terms the court considers 'just and equitable' in the circumstances.<sup>18</sup>

The problem identified for further examination in this chapter is what legal effect business rescue proceedings will have on a creditor's right to enforce its claims against the company's sureties. I also give a brief overview of Chapter 6 of the Act and explain the effect its provisions have on a creditor's rights against sureties of the company. The chapter incorporates the common law, statutory law, and court judgments. Certain of the business rescue provisions are discussed merely to offer background to the effect they have on the liability of a company's sureties while business rescue proceedings are underway.

## 2.2 Commencement of business rescue proceedings

The business rescue process can be initiated in one of the following two ways. Firstly, by means of a resolution passed by the board of the company voluntarily to initiate business rescue proceedings.<sup>19</sup> Secondly, affected parties<sup>20</sup> can apply to a

<sup>15</sup> Section 133(1)(a). See also Rushworth 2010 *Acta Juridica* 383; Delpont *The New Companies Act Manual* 149; Cassim et al *Business Structures* 471.

<sup>16</sup> Section 133(1)(b). Refer to s 128(e) of the Act for the meaning of 'court'. See also Kopel *Business Law* 425; Delpont *The New Companies Act Manual* 149; Bradstreet (2011) 128 *SALJ* 365; Gribnitz & Appelbaum *Business Rescue and Compromise* 34 & 88; Delpont *Henochsberg on the Companies Act* 443 & 450; Cassim et al *Business Structures* 471.

<sup>17</sup> Section 133(2). See also Van Rooyen N "The impact of business rescue proceedings on sureties" available at <http://www.barnardinc.co.za/index.php/articles/20-articles/108-the-impact-of-business-rescue-proceedings-on-sureties> (accessed 19 May 2016).

<sup>18</sup> Section 133(2). See also Gribnitz & Appelbaum *Business Rescue and Compromise* 145; Sharrock et al *Hockly's Insolvency Law* 281; Cassim et al *Business Structures* 472; Mongalo et al *Companies and other Business Structures* 248.

<sup>19</sup> Section 129(1). See also Cassim et al *Contemporary Company Law* 785; Loubser (part 1) 2010 *TSAR* 501; Rushworth 2010 *Acta Juridica* 377; Loubser (2008) 20/3 *SA Merc LJ* 380; Gribnitz & Appelbaum *Business Rescue and Compromise* 99; Delpont *Henochsberg on the Companies Act* 452; Delpont *The New Companies Act Manual* 142; Kopel *Business Law* 425; Wassman 2014 *De Rebus* 36; Stein & Everingham *Companies Act Unlocked* 412; Sharrock et al *Hockly's Insolvency Law* 277; Cassim et al *Business Structures* 461; Mongalo et al *Companies and other Business Structures* 237.

<sup>20</sup> Section 128(1)(a)(i) to (iii) defines an affected person as a shareholder or creditor of the company; any registered trade union representing employees of the company; and if any of the employees of the

court for an order placing the company under supervision and to initiate business rescue proceedings.<sup>21</sup>

### **2.2.1 Voluntary board resolution**

The first method of initiating business rescue proceedings is by way of a resolution which may be adopted only by the board of the company.<sup>22</sup> The resolution to commence business rescue proceedings may be adopted if the board has reasonable grounds to believe that the company is financially distressed<sup>23</sup> and there appears to be a reasonable prospect of rescuing it.<sup>24</sup> The board resolution may not be adopted where liquidation proceedings have already been initiated by or against the company.<sup>25</sup>

Once the board resolution has been adopted, the company must notify and consult with all affected parties as they have a right to participate in the proceedings.<sup>26</sup> Affected persons have three fundamental rights – the right to information; the right to participation in the proceedings; and the right to make an offer.<sup>27</sup> If the company neglects to comply with the prescribed provision, or fails to notify the affected parties of the proceedings, the resolution lapses and is regarded as null and void.<sup>28</sup> Unless

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company are not represented by a registered trade union, each of those employees or their respective representatives. See also Cassim et al *Contemporary Company Law* 786; Loubser (part 1) (2010) *TSAR* 502; Bradstreet (2011) 128 *SALJ* 366; Bradstreet (2010) 22 *SA Merc LJ* 198; Gribnitz & Appelbaum *Business Rescue and Compromise* 34 & 85; Delpont *Henochsberg on the Companies Act* 443; Cassim et al *Business Structures* 463; Mongalo et al *Companies and other Business Structures* 239.

<sup>21</sup> Section 131(1). See also Cassim et al *Contemporary Company Law* 785; Loubser (2008) 20/3 *SA Merc LJ* 380; Loubser (part 1) 2010 *TSAR* 501; Gribnitz & Appelbaum *Business Rescue and Compromise* 123; Sharrock et al *Hockly's Insolvency Law* 277; Cassim et al *Business Structures* 461.

<sup>22</sup> Section 129(1). See also Loubser (2008) 20/3 *SA Merc LJ* 380; Delpont *Henochsberg on the Companies Act* 452; 2014 *De Rebus* 36; Stein & Everingham *Companies Act Unlocked* 412; Cassim et al *Business Structures* 461-2; Mongalo et al *Companies and other Business Structures* 238.

<sup>23</sup> Section 129(1)(a). See also Mongalo et al *Companies and other Business Structures* 240.

<sup>24</sup> Section 129(1)(b). See also Loubser (2008) 20/3 *SA Merc LJ* 381; Rushworth 2010 *Acta Juridica* 377; Delpont *Henochsberg on the Companies Act* 456; Cassim et al *Business Structures* 461; Mongalo et al *Companies and other Business Structures* 240.

<sup>25</sup> Section 129(2)(a). See also Cassim et al *Contemporary Company Law* 785; Rushworth 2010 *Acta Juridica* 377; Delpont *Henochsberg on the Companies Act* 458; Sharrock et al *Hockly's Insolvency Law* 278; Cassim et al *Business Structures* 462; Mongalo et al *Companies and other Business Structures* 238.

<sup>26</sup> Section 130(4). See also Stein & Everingham *Companies Act Unlocked* 416; Sharrock et al *Hockly's Insolvency Law* 278; Mongalo et al *Companies and other Business Structures* 242; Loubser (2008) 20/3 *SA Merc LJ* 380-1.

<sup>27</sup> Section 145(1)(a)-(d). See also Cassim et al *Contemporary Company Law* 800; Gribnitz & Appelbaum *Business Rescue and Compromise* 400.

<sup>28</sup> Section 129(5)(a). See also Loubser (part 1) 2010 *TSAR* 503; Delpont *Henochsberg on the Companies Act* 453 & 460; Stein & Everingham *Companies Act Unlocked* 412; Sharrock et al *Hockly's*

approved by a court, no supplementary resolution will be allowed within a period of three months after the first resolution was adopted.<sup>29</sup> The business rescue proceedings officially begin on the date when the board resolution is filed with the Companies Intellectual Property Commission (CIPC).<sup>30</sup> If affected parties wish to have the board resolution set aside,<sup>31</sup> they may, at any time during the commencement of the business rescue proceedings until the plan has been adopted,<sup>32</sup> apply to court on any of the following grounds.<sup>33</sup> Firstly, there is no reasonable basis for believing that the company is financially distressed.<sup>34</sup> Secondly, there is no reasonable prospect of rescuing the company.<sup>35</sup> Thirdly, the company has failed to comply with procedures prescribed in section 129.<sup>36</sup> In considering the application, the court may set the board resolution aside on any of the grounds listed above, or if it is of the view that it is just and equitable to do so.<sup>37</sup> The court may also afford the business rescue practitioner time to compile a report to determine whether

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*Insolvency Law 277 & 280; Cassim et al Business Structures 463; Mongalo et al Companies and other Business Structures 239.*

<sup>29</sup> Section 129(5)(b). See also Loubser (2008) 20/3 SA Merc LJ 381; Stein & Everingham *Companies Act Unlocked* 412; Sharrock et al *Hockly's Insolvency Law* 278; Cassim et al *Business Structures* 464; Mongalo et al *Companies and other Business Structures* 239.

<sup>30</sup> Section 132(1)(a)(i). In *Investec Bank Ltd v Bruyns* 2012 (5) SA 430 (WCC) para 12 the court held that date on which business rescue proceedings begin depends on what date is meant by the phrase: "[When]... an affected person applies to the court for an order...". See also Cassim et al *Contemporary Company Law* 786; Rushworth 2010 *Acta Juridica* 382; Delpont *Henochsberg on the Companies Act* 478(1); Sharrock et al *Hockly's Insolvency Law* 280; Cassim et al *Business Structures* 462 & 469; Mongalo et al *Companies and other Business Structures* 238.

<sup>31</sup> Section 130(5).

<sup>32</sup> Section 130(1). Confirmed in *African Banking Corporation of Botswana v Kariba Furniture Manufacturers (Pty) Ltd and Others* 2013 (6) SA 471 GNP at para 56. See also Loubser (part 1) 2010 TSAR 505; Bradstreet (2011) 128 SALJ 368; Gribnitz & Appelbaum *Business Rescue and Compromise* 110; Delpont *Henochsberg on the Companies Act* 462(3); Stein & Everingham *Companies Act Unlocked* 414; Sharrock et al *Hockly's Insolvency Law* 278; Cassim et al *Business Structures* 465; Mongalo et al *Companies and other Business Structures* 241.

<sup>33</sup> Section 130(1)(a)(i) to (iii). See also Cassim et al *Contemporary Company Law* 787; Loubser (part 1) 2010 TSAR 505; Delpont *Henochsberg on the Companies Act* 461; Cassim et al *Business Structures* 465; Mongalo et al *Companies and other Business Structures* 241.

<sup>34</sup> Section 130(1)(a)(i). See also Delpont *The New Companies Act Manual* 142; Sharrock et al *Hockly's Insolvency Law* 278; Cassim et al *Business Structures* 465; Mongalo et al *Companies and other Business Structures* 241.

<sup>35</sup> Section 130(1)(a)(ii). See also Delpont *The New Companies Act Manual* 142; Sharrock et al *Hockly's Insolvency Law* 278; Cassim et al *Business Structures* 465; Mongalo et al *Companies and other Business Structures* 241.

<sup>36</sup> Section 130(1)(a)(iii). See also Loubser (2008) 20/3 SA Merc LJ 382; Loubser (part 1) 2010 TSAR 503; Bradstreet (2011) 128 SALJ 368; Gribnitz & Appelbaum *Business Rescue and Compromise* 103; Delpont *Henochsberg on the Companies Act* 461; Delpont *The New Companies Act Manual* 142; Sharrock et al *Hockly's Insolvency Law* 278; Cassim et al *Business Structures* 465; Mongalo et al *Companies and other Business Structures* 241.

<sup>37</sup> Section 130(5)(a)(i) and (ii). See also Cassim et al *Contemporary Company Law* 787; Sharrock et al *Hockly's Insolvency Law* 278; Cassim et al *Business Structures* 465; Mongalo et al *Companies and other Business Structures* 242.

or not the company is financially distressed, or if there are reasonable prospects of rescuing the company.<sup>38</sup> If, after considering the report, the court determines that neither of the above grounds is present, it may set aside the company's resolution.<sup>39</sup>

### **2.2.2 Court order**

The alternative method by which to initiate business rescue proceedings is for an affected person, at any time before the company has adopted a resolution to commence with business rescue proceedings, to apply to court for an order to this effect.<sup>40</sup> Every affected party must be informed of the application<sup>41</sup> and has the right to participate<sup>42</sup> in the hearing of the application.<sup>43</sup> Business rescue proceedings commence once the affected party 'applies' to court.<sup>44</sup> The court will consider the application and may grant an order to commence with business rescue proceedings if it is satisfied either that: the company is financially distressed;<sup>45</sup> or the company has failed to effect payment in terms of an obligation under a public regulation<sup>46</sup> or

<sup>38</sup> Section 130(5)(b)(i) and (ii). See also Cassim et al *Business Structures* 465.

<sup>39</sup> Section 130(5)(b)(ii). See also Stein & Everingham *Companies Act Unlocked* 415; Sharrock et al *Hockly's Insolvency Law* 278; Cassim et al *Business Structures* 465; Mongalo et al *Companies and other Business Structures* 242.

<sup>40</sup> Section 131(1). Refer to *Sibakhulu Construction (Pty) Ltd v Wedgewood Village Golf Country Estate (Pty) Ltd* 2013 (1) SA 191 (WCC) in Delpont *Henochsberg on the Companies Act* 462(2) & 463. See also Cassim et al *Contemporary Company Law* 790; Loubser (2008) 20/3 SA Merc LJ 382; Rushworth 2010 *Acta Juridica* 380; Bradstreet (2011) 128 SALJ 366; Delpont *The New Companies Act Manual* 143; Kopel *Business Law* 425; Wassman 2014 *De Rebus* 36; Stein & Everingham *Companies Act Unlocked* 416; Sharrock et al *Hockly's Insolvency Law* 279; Cassim et al *Business Structures* 467; Mongalo et al *Companies and other Business Structures* 243.

<sup>41</sup> Section 131(2)(b) read with regulation 124. See also Stein & Everingham *Companies Act Unlocked* 417; Cassim et al *Business Structures* 467.

<sup>42</sup> Section 131(3). See also Gribnitz & Appelbaum *Business Rescue and Compromise* 114; Delpont *Henochsberg on the Companies Act* 462(1); Stein & Everingham *Companies Act Unlocked* 417; Sharrock et al *Hockly's Insolvency Law* 279; Cassim et al *Business Structures* 467; Mongalo et al *Companies and other Business Structures* 244.

<sup>43</sup> Section 131(3). See also Loubser (2008) 20/3 SA Merc LJ 382; Rushworth 2010 *Acta Juridica* 380; Bradstreet (2011) 128 SALJ 367; Bradstreet (2013) 130 SALJ 47; Gribnitz & Appelbaum *Business Rescue and Compromise* 124; Delpont *Henochsberg on the Companies Act* 462(1); Stein & Everingham *Companies Act Unlocked* 417; Sharrock et al *Hockly's Insolvency Law* 278; Cassim et al *Business Structures* 467; Mongalo et al *Companies and other Business Structures* 244.

<sup>44</sup> Section 132(1)(b). See also Cassim et al *Contemporary Company Law* 792; Loubser (part 1) 2010 *TSAR* 512; Sharrock et al *Hockly's Insolvency Law* 280; Cassim et al *Business Structures* 469; Mongalo et al *Companies and other Business Structures* 245.

<sup>45</sup> Section 131(4)(a)(i).

<sup>46</sup> Section 131(4)(a)(ii). 'Public regulation' is defined in s 1 of the Act to mean "any national, provincial or local government legislation or subordinate legislation, or any licence, tariff, directive or similar authorisation issued by a regulatory authority or pursuant to any statutory authority." See also Cassim et al *Contemporary Company Law* 791; Cassim et al *Business Structures* 468.

contract in respect of employment-related matters;<sup>47</sup> or lastly, if the court considers it just and equitable to do so for financial reasons.<sup>48</sup>

### 2.3 Business rescue plan

After the commencement of business rescue proceedings, a business rescue practitioner is appointed to develop a business rescue plan.<sup>49</sup> The business rescue plan is developed after consultation with management of the company, its creditors, and other affected persons.<sup>50</sup> The business rescue plan must contain at least the information prescribed in section 150(2), as well as other information necessary to assist affected persons to decide whether they should accept or reject the plan.<sup>51</sup> The company must publish the plan no more than 25 business days after the appointment of the business rescue practitioner.<sup>52</sup> Subsequently, the business rescue practitioner must arrange a meeting with the company's creditors within ten business days after the publication of the plan.<sup>53</sup> The purpose of this meeting is to present the proposed business rescue plan for consideration by the creditors and other holders of voting interests.<sup>54</sup>

If the business rescue plan is supported by holders of more than 75 per cent of the creditors' voting interest – which must include the support of at least 50 per cent of the independent creditors<sup>55</sup> voting interest – it will be approved on a preliminary

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<sup>47</sup> Section 131(4)(a)(ii). See also Loubser (2008) 20/3 *SA Merc LJ* 382; Bradstreet (2011) 128 *SALJ*; Gribnitz & Appelbaum *Business Rescue and Compromise* 125; Delpont *Henochsberg on the Companies Act* 462(8); Kopel *Business Law* 425; Kleitman 2013 *Without Prejudice* 34; Sharrock et al *Hockly's Insolvency Law* 279; Cassim et al *Business Structures* 468; Mongalo et al *Companies and other Business Structures* 245.

<sup>48</sup> Section 131(4)(a)(iii). In *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* 2012 (3) 273 (GSJ) CJ Claassen J held that wording "otherwise just and equitable to do so for financial reasons" meant that the court must consider the financial positions of all stakeholders in business rescue provision, with the exception of the business rescue practitioner. See also Bradstreet (2011) 128 *SALJ* 368; Bradstreet (2013) 130 *SALJ* 48; Delpont *Henochsberg on the Companies Act* 462(8) & 464; Kopel *Business Law* 425; Kleitman 2013 *Without Prejudice* 34; Sharrock et al *Hockly's Insolvency Law* 279; Cassim et al *Business Structures* 468; Mongalo et al *Companies and other Business Structures* 245.

<sup>49</sup> Section 150(1).

<sup>50</sup> Section 150(1). See also Delpont *The New Companies Act Manual* 148.

<sup>51</sup> Section 150(2). See also Delpont *The New Companies Act Manual* 148.

<sup>52</sup> Section 150(5). See also Delpont *The New Companies Act Manual* 148.

<sup>53</sup> Section 151(1). See also Delpont *The New Companies Act Manual* 148.

<sup>54</sup> Section 152. See also Delpont *The New Companies Act Manual* 148.

<sup>55</sup> Refer to definition of independent creditor in s 128(1)(g).

basis.<sup>56</sup> If the plan has been approved on a preliminary basis it will also constitute final approval on condition that it does not affect the rights of holders of any class of the company's securities.<sup>57</sup> If the business rescue plan indeed affects the rights of securities holders, the business rescue practitioner must arrange a meeting with those affected.<sup>58</sup> Should the majority of voting rights at this meeting be in support of the business rescue plan, it will be regarded as having been finally adopted.<sup>59</sup> If the majority oppose the plan it will be regarded as having been rejected.<sup>60</sup>

### **2.3.1 Effect of business rescue plan**

Once a business rescue plan has been adopted it is binding on the company and every creditor and holder of the company's securities regardless of whether they were at the meeting, voted in favour of the plan, or proved a claim.<sup>61</sup> The effect that an adopted business rescue plan will have on sureties of a company is currently uncertain.

Section 154 – which regulates the discharge of debts and claims against the company – provides that a business rescue plan may stipulate that a creditor who has agreed to the discharge of the whole or part of the debt owing to him or her will lose the right to enforce the debt or part of it.<sup>62</sup> The consequences referred to in section 154(2) are conditional upon the adoption and implementation of the business rescue plan.<sup>63</sup> Furthermore, once the business rescue plan has been approved and implemented, the creditor will be unable to enforce any debt owed by the company immediately before the commencement of the business rescue process, save to the extent provided for in the plan.<sup>64</sup>

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<sup>56</sup> Section 152(2). See also Delpont *The New Companies Act Manual* 148; Mahon D “Counting your votes – the voting rights afforded to creditors under business rescue available at <https://sacommerciallaw.com/tag/business/page/3/> (accessed 19 May 2016).

<sup>57</sup> Section 152(3)(b). See also Sharrock et al *Hockly's Insolvency Law* 291.

<sup>58</sup> Section 152(3)(c)(i). See also Sharrock et al *Hockly's Insolvency Law* 291.

<sup>59</sup> Section 152(3)(c)(ii)(aa). See also Sharrock et al *Hockly's Insolvency Law* 291.

<sup>60</sup> Section 152(3)(c)(ii)(bb).

<sup>61</sup> Section 152(4). See also Delpont *Henochsberg on the Companies Act* 535; Cassim et al *Contemporary Company Law* 815; Loubser (part 2) 2010 *TSAR* 694; Gribnitz & Appelbaum *Business Rescue and Compromise* 321; Stein & Everingham *Companies Act Unlocked* 433; Sharrock et al *Hockly's Insolvency Law* 291; Swart & Lombard (2015) 78/3 *THRHR* 528; Cassim et al *Business Structures* 491; Mongalo et al *Companies and other Business Structures* 261.

<sup>62</sup> Section 154(1). See also Cassim et al *Business Structures* 491.

<sup>63</sup> Swart & Lombard (2015) 78/3 *THRHR* 523.

<sup>64</sup> Section 154(2).



In order to determine the position of the creditor who has not agreed to the business rescue plan, the cases of *DH Brothers Industries (Pty) Ltd v Gribnitz NO*<sup>65</sup> and *Tuning Fork (Pty) Ltd T/A Balanced Audio v Greeff*<sup>66</sup> are instructive. In *DH Brothers* the court stated that a business rescue plan may only specify that a creditor who has acceded to the discharge of the whole or part of the debt, may be deprived of its rights to enforce its claims.<sup>67</sup> The court added that because section 152(4) of the Act makes an adopted business rescue plan binding on all creditors, including non-accepting creditors, any provision in the plan which would allow for more than the voluntary discharge of the whole or part of the debt would be regarded as incompetent.<sup>68</sup> In *Tuning Fork* the court criticised the legislature's use of the word 'acceded'. It stated that the use of this word is inappropriate as the legislature could not have intended that the discharge, as contemplated in section 154(1), would depend on the creditor agreeing to it or not.<sup>69</sup>

Consequently, from the wording of section 154(2) "not entitled to enforce any debt owed by the company...unless provided for in the business rescue plan", it can be assumed that, unless otherwise specified in the plan, if a business rescue plan has been adopted and implemented, the creditor will lose the right to enforce any debt owed by the company.<sup>70</sup> The concern with the interpretation of section 154 is whether the debt becomes unenforceable, is discharged, or whether it is extinguished. The distinction can be explained as follows: A debt becomes unenforceable when it is impossible for the creditor to enforce his claim; a claim is discharged when the company is released from its obligation to pay the debt; and extinguished means that the right has been either lost or abolished.<sup>71</sup> Therefore, a creditor will lose its claim against the surety due to the fact that the principal debt has been discharged, if the business rescue plan provides for such a discharge.<sup>72</sup> Should the business rescue

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<sup>65</sup> 2014 (1) SA 103 (KZP).

<sup>66</sup> 2014 (4) SA 521 (WCC).

<sup>67</sup> *DH Brothers* at para 67.

<sup>68</sup> *DH Brothers* at para 67.

<sup>69</sup> *Tuning Fork* at para 77.

<sup>70</sup> Section 154(2). See also Cassim et al *Contemporary Company Law* 816; Gribnitz & Appelbaum *Business Rescue and Compromise* 344; Delpont *Henochsberg on the Companies Act* 535.

<sup>71</sup> Swart & Lombard (2015) 78/3 *THRHR* 523.

<sup>72</sup> Delpont *Henochsberg on the Companies Act* 535. In *Koen and Another v Wedgewood Village Golf and Country Estate (Pty) Ltd and Others* 2012 (2) SA 378 (WCC) at para 10 the court stated that business rescue substantially affects the right of third parties as regards the enforcement of their rights against the company.

plan stipulate that the creditors will be paid in part, in full and final settlement, the principal debt will be extinguished and the sureties can no longer be held liable.<sup>73</sup>

The accessory principle of the law of suretyship provides that the liability of a surety is accessory in nature, meaning that it is dependent on the validity and enforceability of the liability of the principal debtor.<sup>74</sup> Therefore, for the suretyship agreement to be valid there must be a valid principal obligation between the principal debtor and the creditor<sup>75</sup> as, should the principal obligation be discharged, released, or compromised, the same will happen to the accessory obligation.<sup>76</sup>

In *Niemand v Smith's Diary CC and Another*<sup>77</sup> the court considered section 154 and held that the creditor loses the right to recover any debt due once implementation of the business rescue plan has commenced.<sup>78</sup> It added that the word 'implement' in section 154 could mean only commencement of implementation in that the creditor may enforce the debt due and payable to it to the degree provided for in the plan.<sup>79</sup> In concluding the court held that because the business rescue plan, in the present case, had been properly adopted and its implementation had already commenced, the applicant had lost the right to continue with its proceedings based on section 154 of the Act.<sup>80</sup>

## 2.4 Legal consequences for creditors

One of the most important consequences of the commencement of business rescue proceedings is that it provides the company with extensive protection against legal action.<sup>81</sup> This is achieved by placing a general moratorium on legal proceedings and/or executions against the company, its property, assets, and the application of the rights of all its creditors.<sup>82</sup> However, certain legal proceedings are considered

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<sup>73</sup> Delpont *Henochsberg on the Companies Act* 532(2). See also Swart & Lombard (2015) 78/3 *THRHR* 528.

<sup>74</sup> Forsyth & Pretorius *Suretyship* 30. See also Kopel *Business Law* 253; Nagel et al *Commercial Law* 328-9.

<sup>75</sup> Forsyth & Pretorius *Suretyship* 29-30.

<sup>76</sup> *Tuning Fork* at para 53 & 72; *DH Brothers* at para 65. See also Swart & Lombard (2015) 78/3 *THRHR* 527.

<sup>77</sup> 2012 ZAWHC 48.

<sup>78</sup> *Niemand* at para 18.

<sup>79</sup> *Niemand* at para 16.

<sup>80</sup> *Niemand* at para 18.

<sup>81</sup> Cassim et al *Business Structures* 471.

<sup>82</sup> Section 133(1)(a) and (b). See also Cassim et al *Contemporary Company Law* 793; Delpont *Henochsberg on the Companies Act* 478; Kopel *Business Law* 425; Stein & Everingham *Companies*

exceptions and may be instituted during business rescue proceedings. These are: proceedings instituted to ‘set-off’ any claims made by the company in any legal proceedings;<sup>83</sup> criminal proceedings against the company or any of its directors or officers;<sup>84</sup> proceedings regarding the property or rights of the company where it is acting as a trustee;<sup>85</sup> or proceedings by a regulatory authority in the performance of its duties after written notification has been given to the business rescue practitioner.<sup>86</sup>

In an attempt to determine what effect a moratorium will have on a creditor’s right to enforce its claim against the sureties of a company, I examine *Investec Bank Ltd v Bruyns*.<sup>87</sup> It is important to note that in this case, although the debtor company was placed under business rescue, there was no adopted and implemented business rescue plan in place.

The pertinent facts were briefly that Investec Bank sought to enforce a surety given by Bruyns, who had bound himself as surety and co-principal debtor, for the company.<sup>88</sup> The defendant (surety) argued that, in terms of section 132(1)(b), instituting the business rescue application caused the business proceedings to commence and for that reason the creditors’ application for summary judgment should be refused.<sup>89</sup> The basis of its arguments included that: section 133(2) prohibits claims against parties who have executed suretyships in favour of a company in business rescue; the surety can claim the benefit of the moratorium afforded to the company; and that the amount of the principal debt is uncertain as it

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*Act Unlocked* 418; Sharrock et al *Hockly’s Insolvency Law* 280; Cassim et al *Business Structures* 459 & 471; Mongalo et al *Companies and other Business Structures* 248; Van Rooyen N “The impact of business rescue proceedings on sureties” available at <http://www.barnardinc.co.za/index.php/articles/20-articles/108-the-impact-of-business-rescue-proceedings-on-sureties> (accessed 19 May 2016).

<sup>83</sup> Section 133(1)(c). See also Stein & Everingham *Companies Act Unlocked* 418; Sharrock et al *Hockly’s Insolvency Law* 281; Mongalo et al *Companies and other Business Structures* 248.

<sup>84</sup> Section 133(1)(d). See also Stein & Everingham *Companies Act Unlocked* 418; Sharrock et al *Hockly’s Insolvency Law* 281; Cassim et al *Business Structures* 472.

<sup>85</sup> Section 133(1)(e). See also Stein & Everingham *Companies Act Unlocked* 419; Sharrock et al *Hockly’s Insolvency Law* 281; Mongalo et al *Companies and other Business Structures* 248.

<sup>86</sup> Section 133(1)(f). See also Stein & Everingham *Companies Act Unlocked* 419; Sharrock et al *Hockly’s Insolvency Law* 281; Cassim et al *Business Structures* 472; Mongalo et al *Companies and other Business Structures* 248.

<sup>87</sup> 2012 (5) SA 430 (WCC). This case relates to the application for summary judgment.

<sup>88</sup> *Investec* at para 1.

<sup>89</sup> *Investec* at para 11.

may be compromised under an approved business rescue plan.<sup>90</sup> Counsel for the defendant added that the court should not give section 133(2) its plain meaning because section 133(1) already provides a moratorium for claims against the company and a surety's claim against a company is merely one example of a claim that would fall within the ambit of section 133(1).<sup>91</sup>

Rogers AJ rejected the defendant's argument and held that section 133(2) is not a replication of section 133(1), as section 133(2) is so clear-cut that it would be impossible to give it any interpretation other than its plain meaning.<sup>92</sup> He continued to state that section 133(1) is regarded as a general provision which provides the company with protection against legal action on claims, except where written consent has been given by the business rescue practitioner or by a court.<sup>93</sup> Section 133(2), on the other hand, is a special provision relating to the enforcement of claims against the company based on guarantees and suretyships, and specifies that it may only be enforced in such circumstances with leave of a court.<sup>94</sup> The business rescue practitioner is not authorised to consent to the enforcement of claims against the company based on guarantees or suretyships.<sup>95</sup>

The court referred to *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd & Another*<sup>96</sup> and distinguished between *defences in personam* and *defences in rem*<sup>97</sup>. A defence *in personam* affords the principal debtor a personal defence while leaving the debt intact, and may not be raised by the surety.<sup>98</sup> A defence *in rem*, in contrast, attaches to the claim itself and strikes at the existence of the principal debt. This means that the defence must prove that the claim against the principal debtor is either invalid or has been extinguished or discharged.<sup>99</sup>

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<sup>90</sup> *Investec* at para 11.

<sup>91</sup> *Investec* at para 15.

<sup>92</sup> *Investec* at para 16.

<sup>93</sup> *Investec* at para 16.

<sup>94</sup> *Investec* at para 16.

<sup>95</sup> *Investec* at para 16.

<sup>96</sup> 1984 (2) SA 693 (C) 695F-696F.

<sup>97</sup> *Investec* at para 17.

<sup>98</sup> *Investec* at paras 17 & 18. See also Hackner R "The effect of business rescue proceedings on creditors' rights against sureties"

[http://www.fluxmans.com/news/display.asp?r=39.6870823437084&svr=09&session-id=c93a6e8fda8142badc46b1b090aa0fef&lang=en\\_us&id=139&year=2014](http://www.fluxmans.com/news/display.asp?r=39.6870823437084&svr=09&session-id=c93a6e8fda8142badc46b1b090aa0fef&lang=en_us&id=139&year=2014).

<sup>99</sup> *Investec* at para 18.

In the court's view, the statutory moratorium in favour of a company under business rescue, is a defence *in personam* (personal privilege or benefit) and not one for the benefit of the surety.<sup>100</sup> The court added that a business rescue plan may provide for the company to be released from its debts in whole or in part.<sup>101</sup> If a business rescue practitioner tables such a plan and it is approved by the required majority, an affected creditor may lose the right to enforce its claim.<sup>102</sup> Furthermore, if a creditor were to sue a surety, there is always the possibility that the creditor may reach a compromise with the principal debtor, or that the principal debt may be discharged by way of payment.<sup>103</sup> If the creditor secures judgment against the surety and the principal debt is later reduced or discharged, the creditor will still be able to claim the benefit of the discharge or a reduction in the debt.<sup>104</sup>

Rogers AJ further stated that if the legislature intended to prohibit creditors from implementing their claims against the sureties of the company under rescue, it would have stated this.<sup>105</sup> Such a prohibition could constitute a serious invasion of the rights of creditors, and currently there is no language in the Act which allows for such a prohibition.<sup>106</sup> In conclusion, the court held that it could see no reason why the enforcement of claims against sureties should intrude on business rescue proceedings.<sup>107</sup> The company would in any case have to face either the original creditor or the surety as its creditor, depending on the circumstances.<sup>108</sup> The court granted the application for the summary judgment and held that the liability of sureties remains intact up to and until the adoption of a business rescue plan.<sup>109</sup>

*Niemand v Smith's Diary CC and Another*<sup>110</sup> also dealt with section 133. The facts here were briefly the following. The applicant launched an application based on

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<sup>100</sup> *Investec* at para 18 & 19.

<sup>101</sup> *Investec* at para 20.

<sup>102</sup> *Investec* at para 20.

<sup>103</sup> *Investec* at para 22.

<sup>104</sup> *Investec* at para 22.

<sup>105</sup> *Investec* at para 23.

<sup>106</sup> *Investec* at para 23.

<sup>107</sup> *Investec* at para 24.

<sup>108</sup> *Investec* at para 24.

<sup>109</sup> *Investec* at para 25 & 26.

<sup>110</sup> 2012 ZAWHC 48. This case relates to the application for summary judgment. It is important to highlight the differences and similarities between this judgment and that of *Bruyns*. In *Niemand* the applicant's application in terms s 133 failed on the basis of his not having the necessary *locus standi* due to an already approved and adopted business rescue plan. The application is limited to the

section 133(1)(b) of the Act claiming an amount of R736 873,12 from the first respondent.<sup>111</sup> This was done subsequent to a written request to the business rescue practitioner seeking permission to proceed with the action and an application for summary judgment, but was rejected by the business rescue practitioner.<sup>112</sup> The applicant requested permission from the court to proceed with the action, and if successful, to proceed with execution of the judgment.<sup>113</sup> In interpreting section 133(1)(b), the court stated this this particular section should be given a systematic interpretation.<sup>114</sup>

Taking the systematic-interpretation approach into consideration, the court concluded that the applicant did not have the necessary *locus standi* to bring the application.<sup>115</sup> The court reasoned that the right of an affected person to obtain relief from the court is contained in the Act, but there is no such stipulation contained in section 133(1).<sup>116</sup> This case highlights the difference between section 133 and section 154 in that from the commencement of business rescue proceedings until the adoption of the business rescue plan, section 133 will apply. However, after the adoption of the business rescue plan, the consequences of section 154 will apply.

## **2.5 The compromise procedure**

### **2.5.1 Introduction**

In terms of section 155, the board of the company or its liquidator (if the company is in the process of being wound up) may suggest an arrangement or compromise regarding its financial obligations to all of its creditors.<sup>117</sup> A copy of the proposal

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timeframe between the commencement of business rescue and the adoption of a business rescue plan. Whereas in *Bruyns* there was no adopted business plan in place.

<sup>111</sup> *Niemand* at para 3 read with para 5.

<sup>112</sup> *Niemand* at para 7.

<sup>113</sup> *Niemand* at para 6.

<sup>114</sup> *Niemand* at para 12. The court referred to systematic interpretation as follows: "Systematic interpretation is an instance of contextualisation. First, it calls for the interpretation of individual legislative provisions in relation to and in the light of other provisions and components of the legislated text of which they form part, drawing on the 'system' or 'logic' or 'scheme' of the text as a whole. And Secondly systematic interpretation requires cognisance of the ('extra-textual') macro text as well, that is, of meaning-generative signifiers in the textual environment."

<sup>115</sup> *Niemand* at para 12 & 13.

<sup>116</sup> *Niemand* at para 13.

<sup>117</sup> Section 155(2). See also Cassim et al *Contemporary Company Law* 818; Delpont *The New Companies Act Manual* 153; Stein & Everingham *Companies Act Unlocked* 447; Sharrock et al *Hockly's Insolvency Law* 291; Cassim et al *Business Structures* 492.

together with a notice of the meeting to consider the proposal must be delivered to every creditor.<sup>118</sup> The proposal must also contain all the information reasonably required to enable the various creditors to decide whether to accept or reject the proposal.<sup>119</sup> In order for the proposal for compromise to be adopted, a majority of the creditors, representing at least 75 per cent in value, must be present and vote in favour of the proposal.<sup>120</sup> After successful adoption of the proposal, the court may sanction the compromise if it considers it just and equitable to do so.<sup>121</sup>

### **2.5.2 Business rescue proceedings: Similarities and differences**

Both a compromise and business rescue proceedings share the aim of restructuring the financial affairs of a company.<sup>122</sup> The distinction, however, lies in that with a compromise offer it is achieved without the participation of a business rescue practitioner; whereas under business rescue proceedings it involves a procedure for adopting and implementing a business rescue plan to rescue a financially distressed company with the assistance of a practitioner.<sup>123</sup>

Compromise proceedings can be instituted irrespective of whether the company is financially distressed or not;<sup>124</sup> while business rescue proceedings can only be instituted if a company is financially distressed.<sup>125</sup> Furthermore, a compromise does not provide for a statutory moratorium which protects the company from claims by its

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<sup>118</sup> Section 155(2)(a). See also Cassim et al *Contemporary Company Law* 818; Cassim et al *Business Structures* 493.

<sup>119</sup> Section 155(3). See also Cassim et al *Contemporary Company Law* 818; Delpont *The New Companies Act Manual* 153; Stein & Everingham *Companies Act Unlocked* 447; Sharrock et al *Hockly's Insolvency Law* 292; Cassim et al *Business Structures* 484 & 493; Mongalo et al *Companies and other Business Structures* 264.

<sup>120</sup> Section 155(6). See also Cassim et al *Contemporary Company Law* 818; Delpont *The New Companies Act Manual* 153; Stein & Everingham *Companies Act Unlocked* 448; (2015) 78/3 *THRHR* 528; Sharrock et al *Hockly's Insolvency Law* 292; Cassim et al *Business Structures* 494; Mongalo et al *Companies and other Business Structures* 267.

<sup>121</sup> Section 155(7)(b). See also Stein & Everingham *Companies Act Unlocked* 449; Cassim et al *Contemporary Company Law* 819; Delpont *The New Companies Act Manual* 153; Sharrock et al *Hockly's Insolvency Law* 292; Cassim et al *Business Structures* 494; Mongalo et al *Companies and other Business Structures* 267.

<sup>122</sup> Klopper H & Bradstreet R "Does the s 155 compromise further the objectives of business rescue?" available at <http://www.corprecover.co.za/wp/?p=27> (accessed 10 February 2016).

<sup>123</sup> Klopper H & Bradstreet R "Does the s 155 compromise further the objectives of business rescue?" available at <http://www.corprecover.co.za/wp/?p=27> (accessed 10 February 2016).

<sup>124</sup> Gribnitz & Appelbaum *Business Rescue and Compromise* 350.

<sup>125</sup> Section 128 (1)(f). See also Gribnitz & Appelbaum *Business Rescue and Compromise* 350.

creditors; whereas business rescue proceedings do in fact afford the company protection against legal proceedings in the form of a statutory moratorium.<sup>126</sup>

A compromise proposal will only be final and legally binding on all the company's creditors from the date on which a copy of the court order is filed by the company with CIPC.<sup>127</sup> Business rescue proceedings will either commence with the filing of the board's resolution or when an affected party applies to court to commence business rescue proceedings.<sup>128</sup>

Where a company enters into an arrangement or compromise with its creditors, the scheme of arrangement and compromise will not affect the liability of any surety of the company.<sup>129</sup> It is important to note that this is not the case in business rescue proceedings as the Act has no similar provision safeguarding the creditor's rights to hold the surety liable after the adoption of a business rescue plan.<sup>130</sup>

## **2.6 The effect of business rescue proceedings on the liability of sureties: the positive law**

Since the adoption of the Act the position regarding the liability of sureties during business rescue proceedings has remained a somewhat contentious and much-discussed subject in that their position is currently uncertain. The fundamental reasons for this uncertainty can be drawn firstly, from the failure of the Act to address this specific topic; secondly, the unclear wording of section 154(1) and specifically the meaning of the word 'acceded'; and lastly, from conflicting judgments delivered by our courts of law.

I highlight and evaluate the problem created by contradictory judgments by the various divisions of the High Court and what effect business rescue proceedings will have on the liability of the sureties of the company. These judgments can be broadly divided into two groups – those judgments in terms of which the liability of sureties

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<sup>126</sup> Klopper H & Bradstreet R "Does the s 155 compromise further the objectives of business rescue?" available at <http://www.corprecover.co.za/wp/?p=27> (accessed 10 February 2016).

<sup>127</sup> Section 155(8)(c).

<sup>128</sup> Section 129(2)(b) read with s 132(1)(b).

<sup>129</sup> Section 155(9). See also Cassim et al *Contemporary Company Law* 820; Sharrock et al *Hockly's Insolvency Law* 292; Mongalo et al *Companies and other Business Structures* 268; *Tuning Fork (Pty) Ltd T/A Balanced Audio v Greeff* 2014 4 SA 521 (WCC) at paras 25 & 38; Elliott A "Tuning to a common law frequency" available at <http://m.hoganlovells.com/tuning-to-a-common-law-frequency-07-29-2014/> (accessed 10 February 2016).

<sup>130</sup> *Tuning Fork* at para 38. See also Swart & Lombard (2015) 78/3 *THRHR* 524.



remains unaffected by the adoption of a business rescue plan; and those judgments that take the view that the introduction of business rescue proceedings has significantly changed the rights of a creditor to hold the surety of a company liable after the adoption of business rescue plan.

### **2.6.1 Case law holding that creditors' claims are preserved during business rescue proceedings**

In *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd & Others*<sup>131</sup> the first respondent (Kariba) owed the applicant (African Banking Corporation) a sum of money which was secured by suretyships executed by the first respondent's shareholders.<sup>132</sup> The first respondent could not pay the debt and the shareholders decided voluntarily to place the company in business rescue.<sup>133</sup> Subsequently, a meeting in terms of section 151 was held at which the business rescue plan was approved and adopted.<sup>134</sup> It is important to note that in the present case the court did not deal with section 154 of the Act but rather with section 153. Section 153 of the Act relates to the failure to adopt a business rescue plan.

Kathree-Setiloane J stated that there is no provision in Chapter 6 of the Act indicating that the adoption of a business rescue plan will deprive creditors of their respective rights against sureties for the debts of the company in business rescue.<sup>135</sup> In stating this, Kathree-Setiloane J deviated from the *obiter dictum*<sup>136</sup> in the *Investec* case. In her view it would be harsh to deprive creditors of their rights against sureties<sup>137</sup> and if the legislature intended an adopted business rescue plan to have so far-reaching consequences it would have expressly provided for it in legislation.<sup>138</sup> Furthermore, no such a provision could be read into the business rescue administration<sup>139</sup> as in her view the interests of sureties do not fall within the objective of the business rescue

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<sup>131</sup> 2013 (6) SA 471 (GNP).

<sup>132</sup> *African Banking* at para 8.

<sup>133</sup> *African Banking* at para 11.

<sup>134</sup> *African Banking* at para 17.

<sup>135</sup> *African Banking* at para 68.

<sup>136</sup> The *obiter dictum* entails that the statutory moratorium in favour of a company that is undergoing business rescue proceedings is a defence *in personam*. It is a personal privilege or benefit in favour of the company.

<sup>137</sup> *African Banking* at para 68.

<sup>138</sup> *African Banking* at para 68.

<sup>139</sup> *African Banking* at para 69.

administration.<sup>140</sup> The court dismissed the application and held that the adoption of a business rescue plan will not affect a creditor's claim against the surety for the debts of the company.<sup>141</sup> A declaratory order was granted in terms of which the sureties remained liable for the company's debts regardless of the existence of an approved and implemented business rescue plan which provided for the limitation of the creditors' claims.<sup>142</sup> This case highlights the fact that business rescue proceedings will not affect a creditor's right of recourse against a surety of a company under business rescue.

In the case of *Blignaut v Stalcor (Pty) Ltd*<sup>143</sup> a creditor of a close corporation proceeded against the applicant (surety and co-principal debtor of the close corporation) for its full claim.<sup>144</sup> Accordingly, the applicant brought an urgent application precluding the sale in execution of his primary residence.<sup>145</sup> The adopted business rescue plan indicated that each of the creditors would forfeit 75 per cent of their claims against the debtor company.<sup>146</sup> The sureties argued that the adoption of the business rescue plan amounted to a statutory compromise, available to the applicant as a defence *in rem*.<sup>147</sup> They based their argument on the wording of section 154 of the Act<sup>148</sup> and the decision in *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd & Another*.<sup>149</sup>

In response, counsel for the creditors argued that the compromise is not a defence *in rem* but rather purely a defence *in personam* in respect of the second respondent.<sup>150</sup> Furthermore, he drew the court's attention to the definition of business rescue in the Act and stated that it is clear from the latter that it is a defence *in personam* which attaches to the applicable company under business rescue.<sup>151</sup> The court agreed with

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<sup>140</sup> *African Banking* at para 70.

<sup>141</sup> *African Banking* at para 71.

<sup>142</sup> *African Banking* at para 73.

<sup>143</sup> 2014 (6) SA 398 (FB).

<sup>144</sup> *Blignaut* at para 1.

<sup>145</sup> *Blignaut* at para 1.

<sup>146</sup> *Blignaut* at para 11.

<sup>147</sup> *Blignaut* at para 13.

<sup>148</sup> *Blignaut* at para 13.

<sup>149</sup> 1984 (2) SA 693 (C) 695F-696F.

<sup>150</sup> *Blignaut* at para 16.

<sup>151</sup> *Blignaut* at para 18.

this submission and said that it should attempt to establish the true intention of the legislature.<sup>152</sup>

Acting Judge Pohl rejected the sureties' arguments and held that the purpose of business rescue is to provide a financially distressed company with the opportunity to get back onto its 'financial feet'.<sup>153</sup> The court added that it could not have been the intention of the legislature to embrace sureties and co-principal debtors as beneficiaries within the structure of business rescue proceedings and also give them the same benefit of a discharge that the company obtains in terms of section 154 once a plan has been approved<sup>154</sup>. The application was dismissed with costs and the sureties remained liable for the full amount of the debt irrespective of the compromise which existed between the creditor and the debtor company.<sup>155</sup>

In *New Port Finance Company (Pty) Ltd and Another v Nedbank Limited*<sup>156</sup> sureties for the company applied for an interdict preventing the creditor (Nedbank) from taking steps against them for amounts owed to it.<sup>157</sup> These amounts were secured by a deed of suretyship.<sup>158</sup> It is important to note that in the present case the judgment was obtained before the adoption of the business rescue plan.

The sureties argued that because the debtor company's liability had been altered by the business rescue plan, the sureties' liability had also been altered.<sup>159</sup> Unfortunately, the business rescue attempt failed and was terminated.<sup>160</sup> However, the court acknowledged the importance of the legal aspects thereof and provided reasons why the sureties' arguments had failed.<sup>161</sup> It pointed out that the judgments obtained against the sureties secured their liability and there were no grounds for rescinding these judgments, nor had there been any attempt to do so;<sup>162</sup> the creditor had, before the onset of the dispute, taken judgment against the principal debtor and

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<sup>152</sup> *Blignaut* at para 19.

<sup>153</sup> *Blignaut* at para 20.

<sup>154</sup> *Blignaut* at para 20.

<sup>155</sup> *Blignaut* at paras 20 & 21.

<sup>156</sup> 2016 (5) SA 503 (SCA).

<sup>157</sup> *Newport* at para 1.

<sup>158</sup> *Newport* at para 1.

<sup>159</sup> *Newport* at para 3.

<sup>160</sup> *Newport* at para 6.

<sup>161</sup> *Newport* at para 8.

<sup>162</sup> *Newport* at paras 8 & 9.

sureties which established their joint and several liability;<sup>163</sup> and finally, there was no authority for the claim that a compromise of the principal debtor's liability would accumulate to the benefit of a surety after judgment had been taken<sup>164</sup>.

The deed of suretyship was drafted in such a way that it permitted the creditor to pursue action against the sureties irrespective of their dealings with the principal debtors;<sup>165</sup> if the deed of suretyship provided for any instances where the principal debtors would be released from their obligations, it would not prohibit the respondent from recovering any outstanding amount from the sureties.<sup>166</sup>

The suretyship agreement in the present case contained clauses in terms of which the creditor would be entitled to recover the full amount of debt from the sureties irrespective of the release of the principal debtor from its liability.<sup>167</sup> In considering the contents of the business rescue plan, the court stated that the creditor was entitled to recover the full amount from the sureties although the plan reduced the debtor company's liability.<sup>168</sup>

Counsel for the sureties drew the court's attention to the judgment by Rogers J in *Tuning Fork* where he made the *obiter dictum* that in business rescue proceedings the common-law principles of suretyship apply as the Act is silent on this issue.<sup>169</sup> This means that a surety is released if the principal debt is discharged by reason of a compromise with or a release of, the principal debtor.<sup>170</sup> Wallis J disagreed pointing out that the *obiter dictum* made no sense to him.<sup>171</sup> He stated that *Moti and Co v Cassim's Trustee*<sup>172</sup> was decided on the interpretation of the 1916 Insolvency Act<sup>173</sup> which has no direct counterpart in the Act.<sup>174</sup> The court referred to section 154 and stated that its subsection 1 simply states that in certain circumstances a creditor will

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<sup>163</sup> *Newport* at para 9.

<sup>164</sup> *Newport* at para 9.

<sup>165</sup> *Newport* at para 10.

<sup>166</sup> *Newport* at para 12.

<sup>167</sup> *Newport* at para 10.

<sup>168</sup> *Newport* at para 10.

<sup>169</sup> *Newport* at paras 13 & 14.

<sup>170</sup> *Newport* at para 14.

<sup>171</sup> *Newport* at para 13.

<sup>172</sup> 1924 AD 720.

<sup>173</sup> Section 126(2)(b) of the Insolvency Act 32 of 1916.

<sup>174</sup> *Newport* at para 14.

not be able to enforce debts against a company in business rescue.<sup>175</sup> Whereas subsection 2 provides that a company may enforce a debt to the extent permitted by the contents of the business rescue plan.<sup>176</sup> Should that be the case it would mean that the surety's liability would be unaffected by business rescue, unless the business rescue plan provides for a different position.<sup>177</sup> In his view, section 154 can be construed as dealing only with the ability to sue the principal debtor and not with the existence of the debt.<sup>178</sup> The court rejected the sureties' application for an interdict and held that where a judgment has already been granted against sureties before the start of the business rescue proceedings, the sureties' liability will be unaffected by the proceedings.<sup>179</sup>

In *ABSA Bank Limited v Haremza*<sup>180</sup> the defendant bound herself jointly and severally as surety and co-principal debtor in favour of the plaintiff (ABSA Bank).<sup>181</sup> The company was placed in business rescue after which an amended business rescue plan was adopted by the creditors.<sup>182</sup> The business rescue plan stipulated that the company would be sold as a going concern and the plaintiff, as secured creditor, would receive payment to the full extent of the realisation of its securities.<sup>183</sup> Furthermore, clause 6.4 of the plan provided that the sale of the company's assets would be paid to the creditors in settlement of all claims against the respective legal entities, and in full and final settlement of the creditors' claims.<sup>184</sup> An important term in the plan was clause 6.5 which provided that the settlement was not intended to affect any rights that a creditor may have against any third party who bound itself as surety.<sup>185</sup>

Relying on the judgment in *Tuning Fork (Pty) Ltd T/A Balanced Audio v Greeff*,<sup>186</sup> counsel for the defendant argued that the plaintiff's claim against the company had

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<sup>175</sup> *Newport* at para 14.

<sup>176</sup> *Newport* at para 14.

<sup>177</sup> *Newport* at para 14.

<sup>178</sup> *Newport* at para 14.

<sup>179</sup> *Newport* at paras 9 & 14.

<sup>180</sup> (12189/2014) [2015] ZAWCHC 73 (27 May 2015). This case relates to the application for summary judgment.

<sup>181</sup> *Haremza* at para 2.

<sup>182</sup> *Haremza* at para 2.

<sup>183</sup> *Haremza* at para 2.

<sup>184</sup> *Haremza* at para 2 read with para 14.

<sup>185</sup> *Haremza* at para 15.

<sup>186</sup> 2014 (4) SA 521 (WCC).

been extinguished under section 154, and that she could not be held liable for the accessory obligation arising from the deed of suretyship.<sup>187</sup>

Bozalek J, after considering the judgment of *Tuning Fork*, made the *obiter dictum* that Rogers J's perception is that the surety of a principal debtor will be released by a compromise or business rescue plan unless the deed of surety provides otherwise, or the claim against the surety is secured in the business rescue plan.<sup>188</sup> This approach was questioned by the court in *New Port Finance* which stated that section 154 could be interpreted to deal only with the ability to sue the principal debtor and not with the existence of the debt itself.<sup>189</sup> Bozalek J said if this were true, the liability of the surety would be unaffected by the business rescue plan, unless it made specific provision for the position of sureties.<sup>190</sup> She added that were she to apply the approach in *Tuning Fork* to the present matter, the defendant would remain liable as surety because of suretyship's specific terms, and/or by reason of the terms in the business rescue plan which preserved the creditor's rights of recourse against the surety.<sup>191</sup>

The court gave the following reasons for its interpretation. Firstly, the deed of suretyship provided for a wide range of circumstances (judicial management, administration, compromise or arrangement) and these circumstances, in the court's view, could be seen to encompass a business rescue plan.<sup>192</sup> Secondly, clause 8.1.1 of the deed of suretyship allowed the plaintiff to reach a compromise as regards its claim against the principal debtor by way of an arrangement without forfeiting its rights against the surety.<sup>193</sup> Thirdly, the plaintiff's right to proceed against the defendant was supported by the wording of clause 6.3 which permitted the plaintiff, without prejudice to its rights, to enter into any arrangement, compromise or settlement.<sup>194</sup>

The court therefore rejected the defendant's arguments and stated that the parties in the present matter had agreed to the settlement, concluded by way of the business

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<sup>187</sup> *Haremza* at paras 6 & 12.

<sup>188</sup> *Haremza* at para 23.

<sup>189</sup> *Haremza* at para 24.

<sup>190</sup> *Haremza* at para 24.

<sup>191</sup> *Haremza* at para 24.

<sup>192</sup> *Haremza* at para 26.

<sup>193</sup> *Haremza* at para 26.

<sup>194</sup> *Haremza* at para 27.

rescue plan, which provided that it was not intended to affect any rights that a creditor may have against any third party who bound itself as surety.<sup>195</sup> Further, the agreement between the plaintiff and the company was nothing more than a *pactum de non petendo*<sup>196</sup> providing that the surety preserved her right of recourse against the principal debtor.<sup>197</sup> Clause 6.4 of the business rescue plan, which read on its own, could be seen as an unconditional discharge or release subject only to the payment of dividends, and would result in the accessory obligation being extinguished.<sup>198</sup> But, in the light of the contents of clause 6.5, clause 6.4 cannot be read alone, and for that reason it must be construed as a *pactum de non petendo* preserving the plaintiff's right to proceed against the sureties.<sup>199</sup> The court granted the plaintiff's application for summary judgment<sup>200</sup>.

The most recent case law on the issue of the liability of sureties during business rescue proceedings is the unreported case of *Stan Rio Pipe and Steel (Pty) Ltd v Esterhuizen*.<sup>201</sup> Here the plaintiff (creditor) instituted action against the defendant as surety and co-principal debtor based on an application for credit facilities, including a deed of suretyship.<sup>202</sup>

The defendant resisted the applicant's application and argued that the contract of suretyship was invalid due to its non-compliance with section 6 of the General Law Amendment Act, and also because the name of the principal debtor was not recorded therein.<sup>203</sup> The defendant further alleged that the plaintiff's action was *mala fide* and premature as it had already accepted the business rescue plan.<sup>204</sup>

The court's attention was drawn to section 6 of the General Law Amendment Act which states that the Act requires certain essential terms to be embodied in a contract of suretyship.<sup>205</sup> The defendant contended that the current contract of surety

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<sup>195</sup> *Haremza* at para 31.

<sup>196</sup> *Pactum de non petendo* refers to an agreement not to sue.

<sup>197</sup> *Haremza* at para 32.

<sup>198</sup> *Haremza* at para 33.

<sup>199</sup> *Haremza* at para 33.

<sup>200</sup> *Haremza* at para 35.

<sup>201</sup> (64166/2015) [2016] ZAGPPHC 35 (29 January 2016). This case relates to the application for summary judgment.

<sup>202</sup> *Stan Rio Pipe* at paras 1-2.

<sup>203</sup> *Stan Rio Pipe* at para 4.

<sup>204</sup> *Stan Rio Pipe* at para 5.

<sup>205</sup> *Stan Rio Pipe* at para 7.

lacked one of these essential terms – the identity of the principal debtor – and that this rendered the suretyship invalid.<sup>206</sup>

Counsel for the plaintiff rejected this argument and contended that the deed of suretyship, which formed part of the application form, constituted a single document.<sup>207</sup> Also, the principal debt was clearly identifiable and for that reason there had been compliance with section 6 despite the blank space where the name of the principal debtor should have appeared.<sup>208</sup>

The court was faced with two pertinent issues: the validity of the deed of suretyship; and the liability of the surety under the business rescue plan.

Firstly, on the issue of the validity of the deed of suretyship, the court stated that it was satisfied that the deed of suretyship complied with section 6 of the General Law Amendment Act.<sup>209</sup> It provided the following reasons for its decision: the defendant signed the deed of suretyship which clearly indicated his capacity as surety and co-principal debtor;<sup>210</sup> and secondly, in considering the contents of this document, clause 6 provided that any party who signed on behalf of the purchaser (Sansu Steel) binds itself as surety and co-principal debtor *in solidum* in favour of the seller (Stan Rio Pipe and Steel (Pty) Ltd).<sup>211</sup>

In respect of the second issue relating to the liability of the surety under the business rescue plan, counsel for the defendant submitted that once a business rescue plan has been adopted, it provides a defence *in rem* for the surety.<sup>212</sup> He supported his argument by referring to the judgment by Rogers J in *Tuning Fork (Pty) Ltd T/A Balanced Audio v Greeff*.<sup>213</sup>

In contrast, counsel for the plaintiff submitted that the liability of the surety is unaffected by the business rescue plan<sup>214</sup> and relied upon the judgment by Wallis J in *New Port Finance Company (Pty) Ltd and Another v Nedbank Limited*.<sup>215</sup>

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<sup>206</sup> *Stan Rio Pipe* at para 7.

<sup>207</sup> *Stan Rio Pipe* at para 8.

<sup>208</sup> *Stan Rio Pipe* at para 8.

<sup>209</sup> *Stan Rio Pipe* at para 8.

<sup>210</sup> *Stan Rio Pipe* at para 8.

<sup>211</sup> *Stan Rio Pipe* at para 8.

<sup>212</sup> *Stan Rio Pipe* at para 9.

<sup>213</sup> 2014 4 SA 521 (WCC).

<sup>214</sup> *Stan Rio Pipe* at para 9.



The court accepted the plaintiff's submission and held that its right to sue the surety under the deed of suretyship remained unaffected by the business rescue plan.<sup>216</sup> The reasons for its judgment included that reliance by the defendant on the case of *Tuning Fork* was inappropriate, and that *New Port* was a case in point.<sup>217</sup> The court indicated that there was no merit in the defendant's argument that it was never the intention of the parties that it would be personally liable for the principal debtor's liabilities.<sup>218</sup> The language used in both the sale agreement and in the deed of surety was very clear and by admitting to having signed an application for credit, the defendant had renounced a defence of excussion.<sup>219</sup>

The court granted summary judgment in favour of the plaintiff on the basis that the defendant had failed to raise a *bona fide* defence.<sup>220</sup>

### **2.6.2 Case law holding that Creditors lose their claims during business rescue proceedings**

A conflicting judgment disagreeing with the decision by Kathree-Setiloane J in *African Banking*, was delivered by Gorven J in *DH Brothers Industries (Pty) Ltd v Gribnitz NO*.<sup>221</sup> In this particular case the applicant applied to set aside a resolution by the board to commence with business rescue proceedings.<sup>222</sup> The business rescue plan provided for the discharge of 75 per cent of the creditor's claims.<sup>223</sup>

In considering the validity of the business rescue plan the court referred to the moratorium in favour of the company which deprives creditors of the power to enforce their claims against the company.<sup>224</sup> This, in the court's view, provided for a legislative intervention into existing law which deprives creditors of their rights.<sup>225</sup> It is a well-known principle in our law that the legislature does not intend to change existing law more than is necessary – particularly if to do so would extinguish existing

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<sup>215</sup> 2016 (5) SA 503 (SCA).

<sup>216</sup> *Stan Rio Pipe* at para 11.

<sup>217</sup> *Stan Rio Pipe* at para 11.

<sup>218</sup> *Stan Rio Pipe* at para 12.

<sup>219</sup> *Stan Rio Pipe* at para 12.

<sup>220</sup> *Stan Rio Pipe* at paras 14-15.

<sup>221</sup> 2014 (1) SA 103 (KZP).

<sup>222</sup> *DH Brothers* at para 4.

<sup>223</sup> *DH Brothers* at para 4.

<sup>224</sup> *DH Brothers* at para 26.

<sup>225</sup> *DH Brothers* at para 26.

rights.<sup>226</sup> Currently there is a presumption against any forfeiture of rights and any provisions purporting to do so must be interpreted restrictively.<sup>227</sup> The court referred to the *obiter dictum* in *Koen & another v Wedgewood Village Golf and Country Estate (Pty) Ltd & others*<sup>228</sup> where the court stated that the mere institution of business rescue proceedings significantly affects the rights of third parties to enforce their rights against the company.<sup>229</sup>

Gorven J stated that *African Banking* was incorrect in stating that the offeree is adequately protected since it cannot receive less than it would have had the company been liquidated.<sup>230</sup> The court added that the common law provides that the cession of a guaranteed claim brings with it the right to enforce the claim against both the principal debtor and the surety.<sup>231</sup> The cedent will lose this right because it has unavoidably ceded its claim against the principal debtor, and also because suretyship is an accessory obligation.<sup>232</sup>

In examining the business rescue plan, Gorven J drew the inference that because the claims of the creditors had been ceded and the latter was silent as regards the right of the cessionary to enforce the deed of suretyship, the creditors would not be able to hold the sureties liable if the plan were to be adopted and implemented.<sup>233</sup> The court added that section 154 provides that a business rescue plan may only deprive a creditor of its right to enforce its claim, if that creditor has assented to discharge all or part of the debt.<sup>234</sup> Where the plan provides for more than voluntary discharge of a whole or part of the debt, it is not considered valid.<sup>235</sup> The business rescue plan, in the present matter, stated that all the creditors would lose part of their claim, if the plan were to be adopted, irrespective of whether or not they had voted in

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<sup>226</sup> *DH Brothers* at para 26.

<sup>227</sup> *DH Brothers* at para 26.

<sup>228</sup> 2012 (2) SA 378 (WCC).

<sup>229</sup> *Koen* at para 10.

<sup>230</sup> *DH Brothers* at para 55.

<sup>231</sup> *DH Brothers* at para 65.

<sup>232</sup> *DH Brothers* at para 65.

<sup>233</sup> *DH Brothers* at para 66.

<sup>234</sup> *DH Brothers* at para 67.

<sup>235</sup> *DH Brothers* at para 67.

favour of the plan.<sup>236</sup> Even more drastic, they would lose the right to attempt to recover part of their debt from the sureties.<sup>237</sup>

In conclusion, the court found that the effect of the business rescue plan in this matter would be that the sureties would escape liability for 75 per cent of the claims ceded.<sup>238</sup> But what is the legal position regarding the remaining 25 per cent of the claims? The fact that the business rescue plan provided for the discharge of 75 per cent of the creditor's claims meant that they would receive only that percentage of their claims and would be precluded from claiming the remaining 25 per cent from the sureties.

The court added that once the business rescue plan has been adopted, the creditors of the company can no longer hold the sureties liable as their claims have been ceded and the Act does not preserve the right of the cessionary to enforce a suretyship agreement.<sup>239</sup>

In *ABSA Bank Limited v Du Toit and Others*<sup>240</sup> the applicant applied for summary judgment against the defendants (sureties) of the company based on various loans it had advanced to the principal debtor.<sup>241</sup> The principal debtor was placed under business rescue and the adopted business rescue plan provided that the amount paid to the applicant from the principal debtor would be in 'full and final settlement'.<sup>242</sup> The business rescue plan contained two specific provisions: that the amounts made available for payment to creditors in terms of the business rescue plan, would be paid in 'full and final settlement' of any and all claims of the creditors;<sup>243</sup> and that the settlement was not intended to affect any rights that any creditor may have against any third party who had bound itself as surety.<sup>244</sup>

The defendants opposed the application firstly on the basis that the liabilities of the sureties were accessory in nature and that the defendant's liability was conditional on

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<sup>236</sup> *DH Brothers* at para 67.

<sup>237</sup> *DH Brothers* at para 67.

<sup>238</sup> *DH Brothers* at para 68.

<sup>239</sup> *DH Brothers* at para 68.

<sup>240</sup> (7311/ 13) 2013 ZAWCHC 194. This case relates to the application for summary judgment.

<sup>241</sup> *ABSA Bank* at para 1.

<sup>242</sup> *ABSA Bank* at para 2.

<sup>243</sup> *ABSA Bank* at para 10.

<sup>244</sup> *ABSA Bank* at paras 10 & 11.

the existence of the principal obligation.<sup>245</sup> Secondly, they argued that the business rescue plan, specifically in paragraph 6.4, extinguished the principal debtor's debt which also released the sureties from their liability.<sup>246</sup> The defendants submitted that insofar the applicant had lost the right to enforce the principal debt against the company, it was excluded from enforcing the principal debt against the sureties.<sup>247</sup> They alleged that although the business rescue plan attempted to retain ABSA's right of recourse against the defendants as sureties, they were not themselves parties to the business rescue plan.<sup>248</sup>

The applicant claimed that the adoption and implementation of the business rescue plan would not affect any of the creditors' rights against any surety for and on behalf of the principal debtor, and also that their claims had been extinguished.<sup>249</sup> The applicant drew the court's attention to the judgment by Kathree-Setiloane J in *African Banking* where the judge stated that Chapter 6 contains no express provision that the adoption of a business rescue plan will deprive creditors of their right against sureties for the debts of a company in business rescue.<sup>250</sup> If the legislature intended an adopted business rescue plan to have so far-reaching consequences, it would have expressly provided for this in legislation.<sup>251</sup> Counsel for the defendant pointed out that *African Banking* did not deal with section 154 and therefore differs from the present case.<sup>252</sup>

Saldanha J agreed with the defendant's arguments, and in particular that section 154 does not extinguish a third party's liability to a principal debtor, as it is possible to conclude a separate agreement to obtain a guarantee continuing the liabilities of the principal debtor.<sup>253</sup> Furthermore, the business rescue plan can stipulate that the principal debt is not discharged which will mean that the creditor retains its right of recourse against the surety.<sup>254</sup> The court accordingly found in favour of the defendants (sureties) stating that they had raised a *bona fide* defence. The creditors

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<sup>245</sup> *ABSA Bank* at paras 3 & 11.

<sup>246</sup> *ABSA Bank* at paras 3 & 11.

<sup>247</sup> *ABSA Bank* at para 13.

<sup>248</sup> *ABSA Bank* at para 12.

<sup>249</sup> *ABSA Bank* at para 6 read with para 16.

<sup>250</sup> *ABSA Bank* at para 17.

<sup>251</sup> *ABSA Bank* at para 17.

<sup>252</sup> *ABSA Bank* at para 18.

<sup>253</sup> *ABSA Bank* at para 18.

<sup>254</sup> *ABSA Bank* at para 18.

therefore lost their right to enforce their suretyships as it was based on the existence of the principal debt.<sup>255</sup> The application for summary judgment was dismissed.<sup>256</sup>

In *Tuning Fork (Pty) Ltd T/A Balanced Audio v Greeff*<sup>257</sup> the facts were briefly that the debtor company purchased audio and visual equipment from the plaintiff which was subsequently placed in business rescue.<sup>258</sup> A business rescue plan was adopted which indicated that the creditors would receive a dividend of 28,2 cents in the rand in 'full and final' settlement' of their claims.<sup>259</sup> After the adoption of the business rescue plan, but before its implementation, the creditors applied for summary judgment against the sureties.<sup>260</sup> The sureties opposed the application and argued that the creditors' compromise, which was contained in the business rescue plan, released them from their liability.<sup>261</sup>

Rogers J accepted the sureties' argument and summary judgment was refused.<sup>262</sup> The court held that the common law applies because of the *lacuna* in the Act as regards the right of a creditor to hold a surety of the principal debtor liable after the creditor's claims have been settled in full in the adoption and implementation of a business rescue plan.<sup>263</sup> He added that as the principal debt had been discharged in the business rescue plan and the creditor's rights against the sureties were not preserved in either the surety agreement or the business rescue plan, the sureties had been released from their liability.<sup>264</sup>

The court based its decision on the following: the application of the well-known test in terms of which a term that is read into a statute, cannot be used to imply a term in the business rescue provisions;<sup>265</sup> the general principles of the law of suretyship must be applied to determine what effect the provisions in the business rescue plan will have on sureties;<sup>266</sup> the common-law principles of suretyship state that a surety is

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<sup>255</sup> *ABSA Bank* at para 18.

<sup>256</sup> *ABSA Bank* at paras 19 & 21.

<sup>257</sup> 2014 4 SA 521 (WCC). This case relates to the application for summary judgment.

<sup>258</sup> *Tuning Fork* at paras 3 & 5.

<sup>259</sup> *Tuning Fork* at para 6.

<sup>260</sup> *Tuning Fork* at para 12.

<sup>261</sup> *Tuning Fork* at para 12.

<sup>262</sup> *Tuning Fork* at para 14.

<sup>263</sup> *Tuning Fork* at para 14 read with para 36.

<sup>264</sup> *Tuning Fork* at para 14. See also Swart & Lombard (2015) 78/3 *THRHR* 524.

<sup>265</sup> *Tuning Fork* at para 14 read with para 72.

<sup>266</sup> *Tuning Fork* at para 14 read with para 72.

accessory<sup>267</sup> in nature, meaning once the principal obligation has been discharged by a compromise or the release of the principal debtor, the surety will also be released, unless the deed of suretyship or the business rescue plan provides otherwise,<sup>268</sup> and lastly, if the business rescue plan provides for the discharge of the principal debt without preserving the claim against the surety, the surety will be discharged.<sup>269</sup>

Rogers J examined the compromise procedure<sup>270</sup> and related it to his earlier judgment in *Investec*<sup>271</sup> where he had held that the moratorium is a *defence in personam* available to the financially distressed company and cannot be relied upon by the surety.<sup>272</sup> Comparing the present case with *Investec*, Rogers J held that in the present case the moratorium had been displaced by the release of the company against payment to the concurrent creditors of the specified dividend in 'full and final' settlement of their claims.<sup>273</sup> The plaintiff submitted that the legislature would not have intended the surety to be discharged simply because the principal debtor had been released from the claim on the basis of a provision in the business rescue plan.<sup>274</sup>

The court stated that in its view a distinction should be drawn between the legal consequence dictated by statute, and that of the common law in response to a 'statutory event'.<sup>275</sup> If the statute governs a position, it must be applied irrespective of what the common-law provides.<sup>276</sup> If the statute does not address the matter, we should turn to the common law for an answer.<sup>277</sup>

In its judgment the court suggested five possibilities for how the legislature could deal with the position of sureties.<sup>278</sup> The first is where the creditors retain their claims against the sureties, who in return have a right of recourse for their respective claims against the company.<sup>279</sup> The second option is that creditors are able to hold sureties

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<sup>267</sup> *Tuning Fork* at paras 14 & 46. See also Forsyth & Pretorius 187-8.

<sup>268</sup> *Tuning Fork* at para 14 & 46. See also Forsyth & Pretorius 187-8.

<sup>269</sup> *Tuning Fork* at para 14.

<sup>270</sup> Section 155.

<sup>271</sup> 2012 (5) SA 430 (WCC).

<sup>272</sup> *Tuning Fork* at para 21 read with para 27.

<sup>273</sup> *Tuning Fork* at para 35.

<sup>274</sup> *Tuning Fork* at para 36.

<sup>275</sup> *Tuning Fork* at para 37.

<sup>276</sup> *Tuning Fork* at para 37.

<sup>277</sup> *Tuning Fork* at para 37.

<sup>278</sup> *Tuning Fork* case at para 43. See also Swart & Lombard (2015) 78/3 *THRHR* 525-6.

<sup>279</sup> *Tuning Fork* at para 43.

liable, and the sureties will forfeit their claims against the company.<sup>280</sup> Thirdly, the creditor cedes his claim to the surety to enforce during business rescue.<sup>281</sup> The fourth option involves retaining the current model in terms of which the parties negotiate their positions in provisions in the business rescue plan.<sup>282</sup> The final option is that the parties conclude an agreement setting out the liability of sureties during business rescue proceedings.<sup>283</sup>

Rogers J went on to look at the decision in *Moti and Co v Cassim's Trustee's*<sup>284</sup> which relates to the accessory principle in the discharge of the principal debtor by a release or compromise.<sup>285</sup> The majority in *Moti* held that relieving the debtor of its debts would result in the surety also being released from its obligation, even if the law does not so provide.<sup>286</sup> The court referred to Forsyth & Caney's *Law of Suretyship* which provides that as the obligation of a surety is accessory in nature, if the principal obligation is extinguished the surety's obligation will also be extinguished.<sup>287</sup>

In examining section 150(2), Rogers J stated that a business rescue plan is not required to provide for the release of the company from the payment of its debts, it should merely explain the degree of the proposed release.<sup>288</sup> Determining whether the defendants have been discharged will depend largely on the terms of the adopted business rescue plan.<sup>289</sup> Sections 154(1) and section 154(2) were considered and the court found that these two sections overlap.<sup>290</sup> These sections could be considered irrelevant in the light of section 152(4) which provides that an adopted business rescue plan is binding on the company and all its creditors, irrespective of whether they were present, voted at the meeting, or proved a claim.<sup>291</sup> Rogers J stated that the business rescue plan contained no provisions preserving the creditor's

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<sup>280</sup> *Tuning Fork* at para 43.

<sup>281</sup> *Tuning Fork* at para 43.

<sup>282</sup> *Tuning Fork* at para 43.

<sup>283</sup> *Tuning Fork* at para 43.

<sup>284</sup> 1924 AD 720.

<sup>285</sup> *Tuning Fork* at paras 54 & 55.

<sup>286</sup> *Tuning Fork* at paras 54 & 55. See also Musesengwa (2015) February *Without Prejudice* 20.

<sup>287</sup> *Tuning Fork* at para 46. See also Forsyth & Pretorius *Suretyship* 188.

<sup>288</sup> *Tuning Fork* at para 74.

<sup>289</sup> *Tuning case* at para 76.

<sup>290</sup> *Tuning Fork* at para 77.

<sup>291</sup> *Tuning Fork* at para 77.

rights against the sureties, and, therefore, there was no basis for implying such a provision.<sup>292</sup>

The judge referred to the judgment in *African Banking* where it was held that there is no express provision in Chapter 6 of the Act which provides that an adopted business rescue plan will deprive creditors of their respective rights against sureties for the debts of the company in business rescue.<sup>293</sup> She agreed with the statement, but believed there was also no provision in the Act which preserves rights against sureties.<sup>294</sup> Whether the adopted business rescue will affect the creditor's right against a surety will depend largely on the application of the common-law principles of the law of suretyship to the actual provisions of the business rescue plan.<sup>295</sup>

In conclusion, Rogers J stated that the Act specifically provides that a business rescue plan may include provisions relating to the release of the company from its debts and, therefore, the effect of such a release must be determined by taking the common-law principles of the law of suretyship into account.<sup>296</sup> She added that it would also be desirable if the legislature were to amend the Act to clarify the current position.<sup>297</sup> The application for summary judgment was refused.<sup>298</sup>

## 2.7 Conclusion

The Companies Act<sup>299</sup> has introduced a new corporate rescue regime into South African law aimed at providing a financially distressed company with the opportunity to recover financially and to continue operating on a solvent basis.<sup>300</sup> But Chapter 6<sup>301</sup> of the Act – which contains the business rescue provisions – fails to address certain issues. One of these relates to whether creditors lose their claims against sureties of the company while the company is under business rescue, and what

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<sup>292</sup> *Tuning Fork* at para 79.

<sup>293</sup> *African Banking* at para 68.

<sup>294</sup> *Tuning Fork* at para 84.

<sup>295</sup> *Tuning Fork* at para 84.

<sup>296</sup> *Tuning Fork* at para 89.

<sup>297</sup> *Tuning Fork* at para 90.

<sup>298</sup> *Tuning Fork* at para 91.

<sup>299</sup> 71 of 2008.

<sup>300</sup> Section 7(k). See also Swart & Lombard (2015) 78/3 *THRHR* 521; Morgan C “South Africa's new business rescue law - the courts' view” available at <https://www.ensafrica.com/news/South-Africas-new-business-rescue-law-the-courts-view?Id=1412&STitle=insolvency%20ENSight> (accessed 19 May 2016).

<sup>301</sup> Chapter 6 of the Act being ss 128-155.



effect an adopted business rescue plan will have on a creditor's right of recourse against sureties of the company.

The legal position governing the liability of sureties must be approached having regard to the positions before and after the adoption of the business rescue plan. The position before the adoption of the business rescue plan is clear: *Investec Bank v Bruyns*<sup>302</sup> has established that a surety's liability remains intact up to and until the adoption of the business rescue plan.<sup>303</sup> However, the position after the approval and adoption of a business rescue plan is uncertain and has been left to the courts to resolve.<sup>304</sup> The courts have adopted diametrically opposing views holding either that sureties are liable,<sup>305</sup> or they are exempt<sup>306</sup> from liability.

To further complicate the issue, the legislature has couched section 154 in unclear terms through its choice of the word 'acceded'.

Section 154(1) provides that a business rescue plan may contain a provision or provisions in terms of which a creditor who has 'acceded' to the discharge of the whole or part of the debt owing to that creditor, will lose the right to enforce the debt or part of it.<sup>307</sup> Considering the wording of section 154(1), it allows for the interpretation that in certain circumstances a creditor will not be able to enforce its debt against a company in business rescue.<sup>308</sup> But what happens where that creditor does not accede to the business rescue plan? In *DH Brothers*<sup>309</sup> the court reacted to this question by stating that a business rescue plan may only specify that a creditor who has acceded to the discharge of the whole or part of the debt, may be deprived of its rights to enforce its claims.<sup>310</sup> Where the business rescue plan provides for

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<sup>302</sup> 2012 (5) SA 430 (WCC). For a detailed discussion of this case refer to paragraph 2.4 of this dissertation.

<sup>303</sup> *Investec* at paras 25 & 26.

<sup>304</sup> <http://www.fluxmans.com/news/display.asp?id=147&year=2015>.

<sup>305</sup> For case law where sureties remained liable refer to *African Banking Corporation of Botswana Limited v Kariba Furniture Manufactures (Pty) Ltd & Others* 2013 (6) SA 471 GNP; *Blignaut v Stalcor (Pty) Ltd and Others* 2014 (6) SA 398 (FB); *New Port Finance Company (Pty) Ltd and Another v Nedbank Limited* 2016 (5) SA 503 (SCA); *ABSA Bank Limited v Haremza* 2015 ZAWCHC 73.

<sup>306</sup> For case law where sureties were exempt from liability refer to *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* 2014 (1) SA 103 (KZP); *ABSA Bank Limited v Du Toit and Others* 2013 ZAWCHC 194; *Tuning Fork (Pty) Ltd t/a Balanced Audio v Greeff and Another* 2014 (4) SA 521 WCC; *Stan Rio Pipe and Steel (Pty) Ltd v Esterhuizen* (64166/2015) [2016] ZAGPPHC 35.

<sup>307</sup> Section 154(1).

<sup>308</sup> *Newport* at para 14.

<sup>309</sup> 2014 (1) SA 103 (KZP).

<sup>310</sup> *DH Brothers* at para 67.

more than voluntary discharge of a whole or part of the debt, it is not considered valid.<sup>311</sup>

The wording of section 154(2) “not entitled to enforce any debt owed by the company...unless provided for in the business rescue plan” creates the impression that if the business rescue plan has been adopted and implemented the creditor will lose its right of recourse, unless it is preserved by the business rescue plan<sup>312</sup>.

In *New Port Finance* the court considered section 154 and found that it could be interpreted to deal only with the ability to sue the principal debtor, and not the existence of the debt itself.<sup>313</sup> If one considers this interpretation, it boils down to the liability of the surety being unaffected by the business rescue, unless the business rescue plan itself makes specific provision for the position of sureties.<sup>314</sup>

A further concern with the interpretation of section 154 is whether the debt becomes unenforceable, or is discharged or extinguished.<sup>315</sup>

The legislature’s choice of the word ‘acceded’ has also raised considerable debate. In *Tuning Fork* the court criticised the use of this word as inappropriate, and found that the legislature could not have intended that the discharge would depend on the creditor acceding to the plan or not.<sup>316</sup>

Some light can, however, be found in section 155(9) which provides that when a company enters into a compromise with its creditors, it will not affect the liability of any surety of the company.<sup>317</sup> But the compromise mentioned in section 154 must not be confused with a compromise by a company in terms of section 155(9).<sup>318</sup>

Therefore, in light of the conflicting judgments and unclear legislation, the position remains uncertain. No doubt there will still be much deliberation and new case law on this issue.

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<sup>311</sup> *DH Brothers* at para 67.

<sup>312</sup> Cassim *Contemporary Company Law* 816.

<sup>313</sup> *Newport* at para 14.

<sup>314</sup> *Newport* at para 14.

<sup>315</sup> For a detailed discussion of the distinction between unenforceable, discharged and extinguished refer to paragraph 2.3.1 of this dissertation.

<sup>316</sup> *Tuning Fork* at para 77.

<sup>317</sup> Naidoo A “Can you rely on your suretyship in business rescue?” available at <http://succeedblog.co.za/DMKisch/?cat=3> (accessed 9 June 2016).

<sup>318</sup> Refer to a discussion of the differences and similarities between a compromise proposal and the business rescue proceedings in paragraph 2.5.2 of this dissertation.

## CHAPTER 3

### SURETYSHIP UNDER SOUTH AFRICAN LAW

#### 3.1 Introduction

The purpose of this chapter is to introduce the concept of suretyship whilst evaluating the current position of sureties during business rescue proceedings in terms of the Act. I do not provide an historical background of suretyship but restrict my discussion to the aspects highlighted and the relevance of the principles governing surety within the aims of this study.

The following aspects of suretyship are considered:

- Definition of a contract of suretyship.
- Nature of a contract of suretyship.
- The accessory nature of the surety's obligation.
- Formalities of a contract of suretyship.
- Suretyship versus guarantee.
- Liability of the surety.
- Insolvency of the principal debtor or surety.
- Defence actions and right of recourse available to the surety.

#### 3.2 Definition of a contract of suretyship

The authors of Caney's *Law of Suretyship*<sup>319</sup> provide a well-drafted definition of a contract of suretyship: "Suretyship is an accessory contract by which a person (the surety) undertakes to the creditor of another (the principal debtor), that the principal debtor, who remains bound, will perform his obligation to the creditor and that if and so far as the principal debtor fails to do so, the surety will perform it or, failing that, indemnify the creditor". I chose this specific definition based on the support it has received from various Appellate Divisions.<sup>320</sup>

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<sup>319</sup> Forsyth & Pretorius *Suretyship* 28-9. See also Pretorius (2012) 75 *THRHR*, pp. 189-205, 2012 186-7; Stoop & Kelly-Louw 2011 *PELJ* 72.

<sup>320</sup> Refer to *Trust Bank of Africa Ltd v Frysch* 1977 3 SA 562 (A) 584F; *Sapirstein v Anglo African Shipping Co (SA) Ltd* 1978 4 SA 1 (A) 11H; *Nedbank Ltd v Van Zyl* 1990 2 SA 469 (A) 473I in Forsyth & Pretorius *Suretyship* 28. See also Stoop & Kelly-Louw 2011 *PELJ* 72.

### 3.3 Nature of a contract of suretyship

From this definition it can clearly be established that suretyship is accessory to a valid principal obligation<sup>321</sup> in that it depends on the existence, or coming into existence, of the obligation it secures.<sup>322</sup> Several parties are involved in a contract of suretyship: the creditor (person to whom the debt is owed); principal debtor (person who must pay the creditor or comply with its obligations); and the surety (person undertaking the principal debtor's obligation).<sup>323</sup> The surety undertakes its obligation to the creditor<sup>324</sup> of another. This means that the surety and the principal debtor cannot be the same person.<sup>325</sup> The relationship between a debtor and creditor and a resulting obligation can be formed by a contract, delict, or any other legal cause by which a person becomes bound to another as a debtor.<sup>326</sup>

### 3.4 The accessory nature of the surety's obligation

Suretyship is a form of personal security<sup>327</sup> which is accessory to the principal obligation.<sup>328</sup> This means that for the suretyship to be valid, there must be a valid principal obligation between the debtor and the creditor.<sup>329</sup> The principal obligation can arise before the suretyship is undertaken, or even where the surety undertakes liability in respect of a future obligation.<sup>330</sup> This position was confirmed in *GA*

<sup>321</sup> Forsyth & Pretorius *Suretyship* 38. See also Du Bois et al *Wille's Principles of South African Law* 1018.

<sup>322</sup> Kopel *Business Law* 253. See also Forsyth & Pretorius *Suretyship* 30; Nagel et al *Commercial Law* 328-9; Stoop & Kelly-Louw 2011 *PELJ* 73.

<sup>323</sup> Forsyth & Pretorius *Suretyship* 30. See also Nagel et al *Commercial Law* 329; Kopel *Business Law* 261.

<sup>324</sup> Du Bois et al *Wille's Principles of South African Law* 1019.

<sup>325</sup> Forsyth & Pretorius *Suretyship* 43-44.

<sup>326</sup> Forsyth & Pretorius *Suretyship* 39. See also Nagel et al *Commercial Law* 329; Pretorius *Unlimited Suretyships* 188.

<sup>327</sup> Kopel *Business Law* 260.

<sup>328</sup> Pretorius (2012) 75 *THRH* 189. See also Du Bois et al *Wille's Principles of South African Law* 1018.

<sup>329</sup> Forsyth & Pretorius *Suretyship* 29-30 describes the accessory nature of a suretyship as follows: "The fact that the surety's obligations is an accessory obligation is often invested with an air of mystery that apparently justifies without further explanation many aspects of suretyship. In fact the concept is relatively straightforward. It means simply that for there to be a valid suretyship there has to be a valid principal obligation, between the debtor and the creditor. The suretyship is said to be accessory to the transaction which creates the obligation of the principal debtor. Put another way, every suretyship is conditional upon the existence of a principal obligation." See also Nagel et al *Commercial Law* 328-9; Kopel *Business Law* 260; Sharrock *Transactions Law* 763; Du Bois et al *Wille's Principles of South African Law* 1018; Stoop & Kelly-Louw 2011 *PELJ* 73.

<sup>330</sup> Forsyth & Pretorius *Suretyship* 39, 47 & 71. See also Du Bois et al *Wille's Principles of South African Law* 1019; *United Dominians Corporation (SA) Ltd v Rokebrand* 1963 (4) SA 411 (T); Kopel *Business Law* 264; and Forsyth & Pretorius *Suretyship* 41 where the suretyship agreement made provision for debts to be incurred after the registration of the company.

*Odendal v Structured Mezzanine Investments*<sup>331</sup> where the court acknowledged that a contract of suretyship is accessory in nature as there must be a valid principal obligation between the debtor and the creditor. In its judgment the court referred to the position in *Trust Bank of Africa Ltd v Frysch*<sup>332</sup> where Corbett JA stated that the principal obligation need not exist when the suretyship contract is entered into as the suretyship contract can refer to a principal obligation that will only come into existence in the future.<sup>333</sup> However, should there be no principal obligation – for example the apparent obligation is based on forgery or an illegal transaction<sup>334</sup> – no suretyship contract will have been concluded and the surety will not be liable under the void contract of suretyship.<sup>335</sup> *African Life Property Holdings v Score Food Holdings*<sup>336</sup> confirmed this where Nienaber JA compared guaranteeing a non-existent debt with the pointless act of multiplying by nought.

### **3.4.1 Accessory principle and business rescue proceedings**

The accessory principle of suretyship does not, by operation of law, automatically apply to the relationship between a creditor and a surety as both parties will have to agree to its application to their relationship.<sup>337</sup> If the parties agree that the accessory principle does not apply to their relationship, it can be assumed that they intended a guarantee rather than a suretyship agreement.<sup>338</sup>

This principle has caused numerous problems in business rescue proceedings. The common-law principles regarding suretyship provide that the liability of a surety depends on the existence of a principal debt.<sup>339</sup> Therefore, if the principal debt is extinguished, the liability of the surety will also be extinguished.<sup>340</sup> The first contact between the common law and the new business rescue proceedings was in the matter of *African Banking Corporation of Botswana Ltd v Kariba Furniture*

<sup>331</sup> (482/13) 2015 JOL 33675 (SCA) at para 9.

<sup>332</sup> 1977 (3) SA 562 (A) at 584G-H.

<sup>333</sup> Sharrock *Transactions Law* 763. See also Kopel *Business Law* 260, 264.

<sup>334</sup> Forsyth & Pretorius *Suretyship* 38 & 41.

<sup>335</sup> Forsyth & Pretorius *Suretyship* 30 and 38-9. See also Sharrock *Transactions Law* 763; Du Bois et al *Wille's Principles of South African Law* 1018; Kopel *Business Law* 253, 260; Stoop & Kelly-Louw 2011 *PELJ* 73.

<sup>336</sup> 1995 (2) SA 230 (A) at 238F.

<sup>337</sup> Strydom *Die aksessoriteitsbeginsel* 138. See also Swart & Lombard (2015) 78/3 *THRHR* 530.

<sup>338</sup> Strydom *Die aksessoriteitsbeginsel* 138. See also Swart & Lombard (2015) 78/3 *THRHR* 530.

<sup>339</sup> Refer to *Corrans v Transvaal Government and Coull's Trustee* 1909 TS 605 612 in Swart & Lombard (2015) 78/3 *THRHR* 527.

<sup>340</sup> *Tuning Fork* (at para 53).

*Manufacturers (Pty) Ltd & Others*<sup>341</sup> where the court held that business rescue proceedings do not affect a creditor's right of recourse against a surety of a company in business rescue<sup>342</sup>.

In *Tuning Fork (Pty) Ltd T/A Balanced Audio v Greeff*<sup>343</sup> the court considered the interaction between the liabilities of sureties and the accessory principle. Rogers J stated that a distinction should be drawn between the legal consequences dictated by statute, and those of the common law in response to a 'statutory event'.<sup>344</sup> If the statute governs a position, it must be applied irrespective of what the common-law provides.<sup>345</sup> If the statute does not address the matter, an answer should be sought in the common law.<sup>346</sup> The court referred to *Moti and Co v Cassim's Trustee*<sup>347</sup> where the majority of the full bench held that the surety had been released from his obligations to perform.<sup>348</sup> Rogers J argued that because the Act is silent on the right of a creditor to hold a surety of the principal debtor liable, the common law applies, unless the deed of suretyship or the business rescue plan state otherwise.<sup>349</sup> In applying the common-law principles the court held that the principal debt had been discharged in the business rescue plan since the creditor's rights had not been preserved by way of the deed of suretyship or the adopted business rescue plan.<sup>350</sup> This resulted in the sureties being released from their liabilities.<sup>351</sup>

### 3.5 Formalities for a contract of suretyship

Suretyship is a consensual contract<sup>352</sup> which arises from an agreement between the creditor and the surety<sup>353</sup> (in his personal capacity) subject to the requirements for the formation of valid contract.<sup>354</sup> Accordingly, anyone who is legally capable of contracting can bind themselves as surety, except where a surety is not capable of

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<sup>341</sup> 2013 (6) SA 471 (GNP).

<sup>342</sup> *African Banking* at para 71.

<sup>343</sup> 2014 4 SA 521 (WCC).

<sup>344</sup> *Tuning Fork* at para 37.

<sup>345</sup> *Tuning Fork* at para 37.

<sup>346</sup> *Tuning Fork* at para 37.

<sup>347</sup> 1924 AS 720.

<sup>348</sup> *Moti* at para 45.

<sup>349</sup> *Tuning Fork* at para 14 read with 37.

<sup>350</sup> *Tuning Fork* at para 14.

<sup>351</sup> *Tuning Fork* at para 14.

<sup>352</sup> Forsyth & Pretorius *Suretyship* 61.

<sup>353</sup> Du Bois et al *Wille's Principles of South African Law* 1019. See also Nagel et al *Commercial Law* 330.

<sup>354</sup> Forsyth and Pretorius *Suretyship* 61. See also Nagel et al *Commercial Law* 330.

entering into a contract, as this will cause the suretyship to be invalid<sup>355</sup>. In concluding the contract the parties must have a *justa causa* (intention) for entering into a binding contract of suretyship.<sup>356</sup> In addition to the intention, the essential terms to the agreement must also be ascertainable from the content of the contract of suretyship.<sup>357</sup> It is important to note that the principal debtor need not be a party<sup>358</sup> to the contract of suretyship and therefore it can be formed without his knowledge or consent.<sup>359</sup> Before June 1956, the common law<sup>360</sup> did not prescribe whether a contract of suretyship had to be in writing or propose any particular form for its conclusion.<sup>361</sup>

Currently section 6 of the General Law Amendment Act<sup>362</sup> necessitates that the terms of a contract of suretyship must be in writing<sup>363</sup> and signed by or on behalf of both the surety<sup>364</sup> and the creditor<sup>365</sup> for it to be a valid and enforceable agreement.<sup>366</sup> This was confirmed by the Appellate Division in *Fourelmel (Pty) Ltd v Maddison*<sup>367</sup> where the court held that section 6 obliges the surety to sign a written document which represents the contract of suretyship.<sup>368</sup> The Appellate Division provided numerous reasons why the legislature adopted section 6 of the General

<sup>355</sup> Forsyth and Pretorius *Suretyship* 51. See also Kopel *Business Law* 263; Sharrock *Transactions Law* 761.

<sup>356</sup> Forsyth & Pretorius *Suretyship* 63. In *Saambou-Nasionale Bouvereniging v Friedman* 1979 3 SA 978 (A) at 990F-992F the court held that a contract of suretyship also requires a serious and deliberate intention to be bound, but in this case that intention was not by itself sufficient for the contract.

<sup>357</sup> Forsyth & Pretorius *Suretyship* 70 & 88.

<sup>358</sup> Forsyth & Pretorius *Suretyship* 31 & 61-2. See also Nagel et al *Commercial Law* 330; Du Bois et al *Wille's Principles of South African Law* 1019.

<sup>359</sup> Forsyth & Pretorius *Suretyship* 31 & 62. Refer to *Turkstra v Massyn* 1959 (1) SA 40 (T) in Forsyth & Pretorius *Suretyship* 31. See also Sharrock *Transactions Law* 761; Nagel et al *Commercial Law* 330; Du Bois et al *Wille's Principles of South African Law* 1019.

<sup>360</sup> Forsyth & Pretorius *Suretyship* 67. See also Du Bois et al *Wille's Principles of South African Law* 1020.

<sup>361</sup> Kopel *Business Law* 262. See also Nagel et al *Commercial Law* 330; Du Bois et al *Wille's Principles of South African Law* 1020; Stoop & Kelly-Louw 2011 *PELJ* 71.

<sup>362</sup> Act 50 of 1956 provides that "no contract of suretyship entered into after the commencement of this Act shall be valid, unless the terms thereof are embodied in a written document signed by or on behalf of the surety: Provided that nothing in this section contained shall affect the liability of the signer of an aval (suretyship) under the laws relating to negotiable instruments"

<sup>363</sup> Forsyth & Pretorius *Suretyship* 70. See also Nagel et al *Commercial Law* 330; Kopel *Business Law* 262; Magolego *Weighing the Risk* 31.

<sup>364</sup> Person signing on behalf of surety should have authorisation to do so. See also Forsyth & Pretorius *Suretyship* 69; Nagel et al *Commercial Law* 330; Sharrock *Transactions Law* 763; Kopel *Business Law* 262; Du Bois et al *Wille's Principles of South African Law* 1020; Stoop & Kelly-Louw 2011 *PELJ* 83.

<sup>365</sup> Kopel *Business Law* 262.

<sup>366</sup> Stoop & Kelly-Louw 2011 *PELJ* 71.

<sup>367</sup> 1977 (1) SA 333 (A) at 342-3.

<sup>368</sup> Forsyth & Pretorius *Suretyship* 77. Refer to *Fourelmel (Pty) Ltd v Maddison* 1977 (1) SA 333 (A) at 345.

Law Amendment Act. Miller JA specified that one of these was to establish the true terms to which the parties had agreed and so avoid or minimise the likelihood of untruthfulness, fraud, or unnecessary legal action.<sup>369</sup> It is important to note that the surety does not have to be a party to a business rescue plan or an agreement in terms which the principal debt is settled or a compromise is reached since suretyship is accessory to the principal obligation and the surety's right of recourse only arises when the principal debtor fails to pay the creditor.

In *Sapirstein & Others v Anglo African Shipping Co (SA) Ltd*<sup>370</sup> the Appellate Division laid down the *essentialia*<sup>371</sup> of a contract of suretyship:<sup>372</sup> the identity of the creditor,<sup>373</sup> the identity of the principal debtor,<sup>374</sup> the identity of the surety,<sup>375</sup> and the nature and amount of principal debt.<sup>376</sup> As a general rule, these essential terms must be in writing<sup>377</sup> and embodied in the written document. Failure to do so would give rise to non-compliance with section 6 and cause the contract to be void.<sup>378</sup> Where the essential terms cannot be established by reference to the written document, the courts may use extrinsic evidence to identify them.<sup>379</sup> Moreover, should the parties to the contract of suretyship decide on any amendments to its terms, these will have to be made in writing to comply with both the formalities required by contract law and by

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<sup>369</sup> Refer to *Fourlameel (Pty) Ltd v Maddison* 1977 (1) SA 333 (A) at 343.

<sup>370</sup> 1978 (4) SA 1 (A) at 12B-D.

<sup>371</sup> *Nedbank Ltd v Wizard Holdings (Pty) Ltd* 2010 (5) SA (GSJ) where van der Merwe AJ confirmed the essential terms as stated in *Sapirstein & Others v Anglo African Shipping Co (SA) Ltd* and added that the failure to complete the essential terms of the suretyship agreement would make the agreement invalid.

<sup>372</sup> Forsyth & Pretorius *Suretyship* 69.

<sup>373</sup> Forsyth & Pretorius *Suretyship* 70. Refer to *Creutzburg v Commercial Bank of Namibia Ltd* 2006 4 All SA 327 (SCA) where the court held that the deed of suretyship in which the identity of creditor is not disclosed is regarded as invalid as it does not comply with s 6 of the General Law Amendment Act. See also Nagel et al *Commercial Law* 330; Kopel *Business Law* 262; Du Bois et al *Wille's Principles of South African Law* 1020.

<sup>374</sup> Forsyth & Pretorius *Suretyship* 70. See also Nagel et al *Commercial Law* 330; Kopel *Business Law* 262; Du Bois et al *Wille's Principles of South African Law* 1020.

<sup>375</sup> Forsyth & Pretorius *Suretyship* 70. See also Nagel et al *Commercial Law* 330; Kopel *Business Law* 262; Du Bois et al *Wille's Principles of South African Law* 1020.

<sup>376</sup> Forsyth & Pretorius *Suretyship* 70. See also Nagel et al *Commercial Law* 330; Kopel *Business Law* 262; Du Bois et al *Wille's Principles of South African Law* 1020. Refer to *Nedbank Ltd v Wizard Holdings (Pty) Ltd* 2010 (5) SA (GSJ) where Van der Merwe AJ stated if a space for the inclusion of a non-essential term is left blank, the intention of the parties will be interpreted that such term should not form part of the agreement.

<sup>377</sup> Forsyth & Pretorius *Suretyship* 71.

<sup>378</sup> Forsyth & Pretorius *Suretyship* 70.

<sup>379</sup> Forsyth & Pretorius *Suretyship* 71 & 72. Refer to *Sapirstein v Anglo African Shipping Co (SA) Ltd* 1978 4 All SA 474 (A) where the court held that s 6 requires that the 'terms' of the contract of suretyship must be embodied in the written document. See also Kopel *Business Law* 262; Du Bois et al *Wille's Principles of South African Law* 1020.



the General Law Amendment Act.<sup>380</sup> An oral variation of a suretyship contract will not be permitted as it will not comply with section 6.<sup>381</sup> However, the parties can agree to the oral cancellation of the agreement.<sup>382</sup>

### 3.6 Suretyship and the contract of guarantee

I discussed the nature of suretyship earlier in this chapter. A contract of guarantee is considered to arise where the guarantor assumes a principal obligation to indemnify the promisee on the occurrence of certain events.<sup>383</sup> From this it is clear that a contract of guarantee does not depend on the existence of any other debt or agreement,<sup>384</sup> unlike a contract of suretyship<sup>385</sup>.

Lubbe<sup>386</sup> illustrates their distinct natures as follows: the guarantor's obligation, which is independent of that of the debtor, is to indemnify the creditor as a result of the debtor's non-performance.<sup>387</sup> Whereas, the surety is only liable for losses ensuing from the debtor's non-performance<sup>388</sup>. Secondly, the surety undertakes that the debtor will perform, and only if he fails to perform, will the surety perform in his place.<sup>389</sup> In the case of a guarantee the guarantor agrees to pay on the occurrence of a certain event, but does not give an assurance that the event will not occur.<sup>390</sup> If the debtor's contract is invalid – for whatsoever reason – the guarantor's responsibility will remain in force and he will still be liable to pay, while the surety's responsibility will be extinguished and he will have to pay nothing.<sup>391</sup> The matter of *List v Jungers*<sup>392</sup> is still used as precedent when a distinction between contracts of guarantee and suretyship has to be made. In this case the Appellate Division held

<sup>380</sup> Nagel et al *Commercial Law* 330.

<sup>381</sup> Forsyth & Pretorius *Suretyship* 81. See also Nagel et al *Commercial Law* 330; Kopel *Business Law* 262.

<sup>382</sup> Forsyth & Pretorius *Suretyship* 81. See also Nagel et al *Commercial Law* 330; Kopel *Business Law* 262.

<sup>383</sup> Forsyth & Pretorius *Suretyship* 32. See also Pretorius (2001) 13 *SA Merc LJ* 97; Stoop & Kelly-Louw 2011 *PELJ* 69.

<sup>384</sup> Nagel et al *Commercial Law* 330. See also <http://www.bowman.co.za/News-Blog/Blog/the-contract-of-guarantee-in-south-african-law>.

<sup>385</sup> For a detailed discussion of the nature of guarantees and sureties refer to the general article by Stoop & Kelly-Louw 2011 *PELJ*.

<sup>386</sup> Lubbe (1984) 47 *THRHR* 391-2. See also Forsyth & Pretorius *Suretyship* 33.

<sup>387</sup> Forsyth & Pretorius *Suretyship* 33. See also Pretorius (2001) 13 *SA Merc LJ* 98.

<sup>388</sup> Forsyth & Pretorius *Suretyship* 33. See also Pretorius (2001) 13 *SA Merc LJ* 98.

<sup>389</sup> Forsyth & Pretorius *Suretyship* 34. See also Pretorius (2001) 13 *SA Merc LJ* 98; Du Bois et al *Wille's Principles of South African Law* 1021.

<sup>390</sup> Forsyth & Pretorius *Suretyship* 34. See also Pretorius (2001) 13 *SA Merc LJ* 98.

<sup>391</sup> Forsyth & Pretorius *Suretyship* 33.

<sup>392</sup> 1979(3) SA 106 (A) at 117-119.

that the words 'guarantee' and 'warrant' have an assortment of meanings and their exact meaning must be established from the particular context in which they are used.<sup>393</sup> The court agreed with the view of Greenberg J in *Walker's Fruit Farms Ltd v Sumner*<sup>394</sup> where he stated that the word 'guarantee' is itself capable of a number of meanings, but if you adopt its ordinary meaning it means to assure a person of receipt or possession of something.<sup>395</sup>

The advantage of a creditor using a guarantee rather than suretyship to secure his claim, is that it will be entitled to proceed with its claim against the guarantor, as it will be unaffected by the business rescue proceedings, the plan, or the clarification of section 154.<sup>396</sup> In order to protect the rights of creditors, the authors Swart and Lombard<sup>397</sup> have proposed the following: creditors should consider using other forms of personal security and the deed of suretyship should be correctly phrased to preserve the creditor's right against the provider of security independently of the business rescue plan.<sup>398</sup>

### 3.7 Liability of the surety

The general position in practice is that should the principal debtor fail to pay or to pay in full, the creditor can hold the surety liable for payment.<sup>399</sup> Thereafter, the surety will have a right of recourse against the debtor.<sup>400</sup> The surety's obligation together with its liability is limited to the obligation it has undertaken<sup>401</sup> and originates from the moment that the principal debtor defaults in execution of its principal obligations.<sup>402</sup> This was illustrated in *Trans-Drakensberg Bank Ltd v Guy*<sup>403</sup> where Miller J stated

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<sup>393</sup> List at p 120.

<sup>394</sup> 1930 TPD 394 at 398.

<sup>395</sup> Forsyth & Pretorius *Suretyship* 98.

<sup>396</sup> Swart & Lombard (2015) 78/3 *THRHR* 530.

<sup>397</sup> Swart & Lombard (2015) 78/3 *THRHR* 532.

<sup>398</sup> Swart & Lombard (2015) 78/3 *THRHR* 532.

<sup>399</sup> Forsyth & Pretorius *Suretyship* 31-2 159-70. See also Du Bois et al *Wille's Principles of South African Law* 1025; Stoop & Kelly-Louw 2011 *PELJ* 77.

<sup>400</sup> Forsyth & Pretorius *Suretyship* 31-2 159-70. See also Du Bois et al *Wille's Principles of South African Law* 1025; Stoop & Kelly-Louw 2011 *PELJ* 77.

<sup>401</sup> Forsyth & Pretorius *Suretyship* 101. Refer to *Trans-Drakensberg Bank Ltd v Guy* 1964 (1) SA 790 (D) in Forsyth & Pretorius *Suretyship* 101. See also Du Bois et al *Wille's Principles of South African Law* 1021.

<sup>402</sup> Sharrock *Transactions Law* 766. See also Nagel et al *Commercial Law* 331.

<sup>403</sup> 1964 (1) SA 790 (D) at 795-6.

that where the surety has agreed to an amount or cause, its liability will be limited to the amount or cause as stated in the contract of suretyship.<sup>404</sup>

The surety's liability cannot exceed that of the debtor, but can be equivalent to it or even lower.<sup>405</sup> This principle was confirmed in *Wessels v The Master of the High Court*<sup>406</sup> where the court held that when a surety binds itself for more than the debtor's obligation, it will only be liable to the extent of the obligation. In proving the amount of the principal debtor's indebtedness, the suretyship may stipulate that a certificate of indebtedness be provided.<sup>407</sup> If the principal debt is for an undefined<sup>408</sup> amount, the surety's liability to pay the amount is secured once this amount has been determined<sup>409</sup> and secured by a judgment of the court.<sup>410</sup>

The surety cannot be held liable for the debt until it is actually due by the principal debtor.<sup>411</sup> Therefore, in essence the surety's liability is conditional in that it will only be liable towards the creditor in the event of a breach of contract by the principal debtor.<sup>412</sup> Depending on the terms of the contract of suretyship, where the surety has bound itself only to a stated amount, it cannot be held liable for any interest, should it be charged against the debtor.<sup>413</sup> But this situation changes when the surety places itself *in mora*<sup>414</sup> as it will then be liable for interest, provided that the interest does not exceed the capital amount.<sup>415</sup> In the final analysis, the surety will only be liable for what is stipulated in the contract of suretyship.<sup>416</sup>

As pointed out, the surety and the principal debtor cannot be the same person,<sup>417</sup> but it is possible for a surety to bind itself as both surety and co-principal debtor<sup>418</sup> by expressly stipulating this in the contract of suretyship.<sup>419</sup> The key distinction between

<sup>404</sup> Forsyth & Pretorius *Suretyship* 101.

<sup>405</sup> Forsyth & Pretorius *Suretyship* 102. See also Sharrock *Transactions Law* 764.

<sup>406</sup> (1891) 9 SC 18.

<sup>407</sup> Forsyth & Pretorius *Suretyship* 114.

<sup>408</sup> Forsyth & Pretorius *Suretyship* 47.

<sup>409</sup> Forsyth & Pretorius *Suretyship* 104.

<sup>410</sup> Sharrock *Transactions Law* 766.

<sup>411</sup> Forsyth & Pretorius *Suretyship* 104.

<sup>412</sup> Lubbe (1994) 47 *THRHR* 383 & 386.

<sup>413</sup> Forsyth & Pretorius *Suretyship* 115.

<sup>414</sup> *In mora* means a wilful delay or default in fulfilling a legal obligation.

<sup>415</sup> Forsyth & Pretorius *Suretyship* 116.

<sup>416</sup> Du Bois et al *Wille's Principles of South African Law* 1022.

<sup>417</sup> Refer to footnote 328.

<sup>418</sup> Forsyth & Pretorius *Suretyship* 56. See also Du Bois et al *Wille's Principles of South African Law* 1022.

<sup>419</sup> Forsyth & Pretorius *Suretyship* 56.

the liability of a surety and the liability where the surety has also bound itself as co-principal debtor, is illustrated in the case of *Neon and Cold Cathode Illuminations (Pty) Ltd v Ephron*.<sup>420</sup> Here the court held that generally the only consequence arising from circumstances in which a surety also binds itself as co-principal debtor, is that it implicitly renounces the ordinary benefits (benefits of excussion<sup>421</sup> and division<sup>422</sup>) available to the surety and becomes jointly and severally liable together with the principal debtor.<sup>423</sup> However, a different point of view was taken in *Firststrand Bank v Carl Beck Estates (Pty) Ltd*<sup>424</sup> where the court held that a surety who binds itself as both surety and co-principal debtor will remain a surety, as its liability arises entirely from the contract of suretyship. The court added that signing as surety and co-principal debtor does not make the surety liable in any capacity other than that of a surety who has renounced the benefits of excussion and division.

In *Tuning Fork (Pty) Ltd T/A Balanced Audio v Greeff*,<sup>425</sup> which dealt with the liability of sureties during business rescue proceedings, the court stated that a distinction should be drawn between the liability of sureties before the adoption of a business rescue plan and after its adoption.<sup>426</sup> Before the adoption of the business rescue plan the debtor is liable to the creditor for the original principal debt as stipulated in the contract of suretyship.<sup>427</sup> After the adoption and implementation of the business rescue plan the creditor will be bound by the business rescue plan irrespective of whether or not it voted against the plan.<sup>428</sup> Therefore, the right of a creditor to hold a surety liable after the adoption of a business rescue plan will depend largely on the wording of the plan.<sup>429</sup> If the plan provides that the creditor's claim will be paid

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<sup>420</sup> 1978 (1) SA 463 (A).

<sup>421</sup> The benefit of excussion refers to the right of the surety against the creditor to first demand performance from the principal debtor to try and obtain payment from him, before proceeding to the surety for payment. See Forsyth & Pretorius *Suretyship* 125; Kopel *Business Law* 267.

<sup>422</sup> This benefit determines that where there are two or more sureties, they will be liable *in solidum*. See Kopel *Business Law* 265 & 267; Du Bois et al *Wille's Principles of South African Law* 1022; Nagel et al *Commercial Law* 332.

<sup>423</sup> At 472B-C. Also refer to *Trans-Drakensberg Bank Ltd v The Master* 1962 (4) SA 417 in Stoop & Kelly-Louw 2011 *PELJ* 85.

<sup>424</sup> 2009 (2) SA 384 (T) at paras 22-24

<sup>425</sup> 2014 (4) SA 521 (WCC).

<sup>426</sup> *Tuning Fork* case at paras 34-35. See also Swart & Lombard (2015) 78/3 *THRHR* 528.

<sup>427</sup> *Tuning Fork* at paras 34-35. See also Swart & Lombard (2015) 78/3 *THRHR* 528.

<sup>428</sup> *Tuning Fork* at paras 34-35. See also Swart & Lombard (2015) 78/3 *THRHR* 528.

<sup>429</sup> Delpont *Henochsberg on the Companies Act* 532(2). See also Swart & Lombard (2015) 78/3 *THRHR* 528.

partially in full and final settlement, the principal debt will be extinguished and the surety can no longer be held liable.<sup>430</sup>

### 3.8 Insolvency of the principal debtor or surety

The principal debtor's insolvency will not release the surety nor will it be immediately liable for the debt payable (if it is not yet payable), as the surety becomes a conditional creditor of the principal debtor's insolvent estate.<sup>431</sup> This was confirmed by Van Der Heever JA in *Kalil v Standard Bank of South Africa Ltd*<sup>432</sup> where the court held that the insolvency of the surety does not terminate the suretyship and creditors are permitted to prove a claim for any amounts currently due to them. A creditor of the principal debtor will also be a creditor of the surety, even if the surety has the benefit of excussion at its disposal.<sup>433</sup> The creditor's claim is reliant on both the principal debtor's default and excussion (if the surety has the benefit of excussion).<sup>434</sup> In the absence of the surety enjoying this benefit, the creditor will have to prove its claim against the insolvent estates.<sup>435</sup> Where the creditor has successfully proved its claim against any of the insolvent estates, it will be entitled to receive dividends from every insolvent estate.<sup>436</sup> Where it receives only partial payment from the principal debtor or its insolvent estate before proving its claim, the creditor will still have a claim for the balance.<sup>437</sup> The surety will be discharged to the extent of payment received from the principal debtor or its estate.<sup>438</sup> A creditor will not be entitled to recover more than the total amount owed to it and any amount it may receive in excess must be paid back to the last payer in time.<sup>439</sup>

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<sup>430</sup> Delpont *Henochsberg on the Companies Act* 532(2). See also Swart & Lombard (2015) 78/3 *THRHR* 528.

<sup>431</sup> Forsyth & Pretorius *Suretyship* 168 & 119-20. See also Du Bois et al *Wille's Principles of South African Law* 1027; s 139(3)(d) of the Insolvency Act 24 of 1936.

<sup>432</sup> 1967 (4) SA 550 (A) at 557.

<sup>433</sup> Forsyth & Pretorius *Suretyship* 120.

<sup>434</sup> Forsyth & Pretorius *Suretyship* 120.

<sup>435</sup> Forsyth & Pretorius *Suretyship* 120.

<sup>436</sup> See *De Wet Bros v The Master and Another* 1934 CPD 427 at 430-433 in Forsyth & Pretorius *Suretyship* 120.

<sup>437</sup> See *De Wet Bros v The Master and Another* 1934 CPD 427 at 430-433 in Forsyth & Pretorius *Suretyship* 120.

<sup>438</sup> Forsyth & Pretorius *Suretyship* 120.

<sup>439</sup> Forsyth & Pretorius *Suretyship* 120.

### 3.9 Defence actions available to the surety

The surety's obligation is accessory to that of the principal debtor, meaning that the surety will be able to raise, rely upon, or plead any defence available to the principal debtor.<sup>440</sup> A distinction is drawn between defences:

- *in personam*; and
- *in rem*.

The distinction between the two defences was highlighted in *Standard Bank of SA v SA Fire Equipment (Pty) Ltd & another*<sup>441</sup> where Rose-Innes J held that the difference between defences *in rem* and defences *in personam* lies in that defences *in rem* attach to the claim, the cause of action, or the obligation itself and arise from the invalidity, extinction, or discharge of the obligation. Defences *in personam*, on the other hand, arise from a personal immunity of the debtor from liability for an otherwise valid and existing civil or natural obligation. Furthermore, with a defence *in personam* the obligation and the debt remain intact, while the debtor is personally protected from a claim. In the case of defence *in rem* the obligation and debt are not recognised by law – not even as natural obligations.

The Act provides in section 133 for a statutory moratorium in favour of the company under business rescue against any legal proceedings or executions against the company, its property and assets.<sup>442</sup> The case of *Standard Bank of SA v SA Fire Equipment (Pty) Ltd & another* was highlighted in *Investec v Bruyns*<sup>443</sup> where the court held that the moratorium is a defence *in personam* available to the company and cannot be applied to the benefit of the surety.<sup>444</sup> The court held further that the liability of the sureties would stay intact until the adoption of a business rescue plan.<sup>445</sup>

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<sup>440</sup> Forsyth & Pretorius *Suretyship* 30 & 189. See also Nagel et al *Commercial Law* 331; Pretorius (2001) 13 *SA Merc LJ* 99.

<sup>441</sup> 1984 (2) SA 693 (C) at 697.

<sup>442</sup> Section 133(1).

<sup>443</sup> 2012 (5) SA 430 (WCC).

<sup>444</sup> *Investec* at paras 18 & 19.

<sup>445</sup> *Investec* at para 18.

### 3.9.1 Defences in personam ('personal defences')

A defence *in personam* refers to a personal action or proceeding directed against a specific person arising from a contract or a delict.<sup>446</sup> In simple terms it denotes defences which are purely personal to the principal debtor and which are not available to the surety.<sup>447</sup> Examples of defences *in personam* include: the debtor is a minor; the insolvency or liquidation of the principal debtor; or a legal moratorium.<sup>448</sup>

### 3.9.2 Defences in rem ('real defences')

The surety is entitled to raise any defence against the creditor that the principal debtor could have raised, with the exception of the personal defences available only to the principal debtor.<sup>449</sup> Examples of defences *in rem* include: invalidity; mental illness; duress; payment; novation; judgment; misrepresentation; and set off.<sup>450</sup>

## 3.10 Surety's right of recourse

### 3.10.1 Introduction

The surety has right of recourse against the debtor once it has paid the debt of the principal debtor to the creditor.<sup>451</sup> This right of recourse will be executed by way of the *actio mandati* contingent on whether the suretyship was undertaken with the knowledge and approval of the principal debtor (*actio mandati*), or without it (*actio negotiorum gestorum*).<sup>452</sup> The surety is entitled to be indemnified against not only the amount of debt paid, but also any damages, loss, and expenses incurred due to the debtor's breach of contract.<sup>453</sup> Included in these losses and expenses are costs

<sup>446</sup> Du Bois et al *Wille's Principles of South African Law* 46.

<sup>447</sup> Du Bois et al *Wille's Principles of South African Law* 1023.

<sup>448</sup> Forsyth & Pretorius *Suretyship* 189. See also Du Bois et al *Wille's Principles of South African Law* 1023; Nagel et al *Commercial Law* 331; Forsyth & Pretorius *Suretyship* 189; Nagel et al *Commercial Law* 331.

<sup>449</sup> Forsyth & Pretorius *Suretyship* 189. See also Kopel *Business Law* 263; Sharrock *Transactions Law* 766; Du Bois et al *Wille's Principles of South African Law* 1022.

<sup>450</sup> Forsyth & Pretorius *Suretyship* 189. In *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd* 1984 2 SA 693 (C) at 697 the court said that in the case of a defence *in rem* the law does not recognise the obligation or debt even as a natural obligation or no obligation in fact came into existence or was vitiated on a ground justifying its termination (mistake, misrepresentation, duress), or the obligation has terminated because it has been discharged or otherwise extinguished (payment, compromise, novation, judgment). See also Kopel *Business Law* 264; Sharrock *Transactions Law* 766; Du Bois et al *Wille's Principles of South African Law* 1022; Nagel et al *Commercial Law* 331.

<sup>451</sup> Forsyth & Pretorius *Suretyship* 159.

<sup>452</sup> Forsyth & Pretorius *Suretyship* 31 62 & 159. See also Du Bois et al *Wille's Principles of South African Law* 1026.

<sup>453</sup> Forsyth & Pretorius *Suretyship* 161. See also Kopel *Business Law* 265.

incurred by the creditor in suing the principal debtor.<sup>454</sup> Before the surety can request that the principal debtor indemnify it, it must have made a valid payment<sup>455</sup> of the debt to the correct creditor<sup>456</sup> and have informed the debtor accordingly.<sup>457</sup> The payment can have been made voluntarily or on the basis of a judgment or court order.<sup>458</sup>

An important consideration is whether the surety's right of recourse will keep the company in financial distress. This will involve that after the creditor has successfully executed its right of recourse against the surety, the surety will in turn seek recourse against the company.<sup>459</sup> The surety will attempt to enforce its right of recourse and if unsuccessful, possibly attempt to liquidate the company. The company would consequently be exposed to the same claims, but from the surety and not the creditor.<sup>460</sup> Currently this position is not addressed but should the legislature intend that the surety will indeed retain its right of recourse, it will certainly have devastating consequences for the company.

Another important consideration is that where the surety could be deprived of its right of recourse, such action may be considered unconstitutional. In *Tuning Fork (Pty) Ltd T/A Balanced Audio v Greeff*<sup>461</sup> – where the court attempted to address the gap in the Act by suggesting possible solutions – it was stated that if sureties were to lose their right of recourse, it would benefit both the distressed company and the creditor, but would be unfair to the surety as it would be rendered voiceless and without a remedy.<sup>462</sup> In *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd & Others*<sup>463</sup> the court was faced with the question of whether such a deprivation of rights falls within the meaning of section 25 of the Constitution.<sup>464</sup> The applicant (ABSA Bank) challenged the constitutionality of section 153(1)(b)(ii) by firstly alleging that section 154 deprived it of its right to exercise its voting rights at the meeting of creditors, secondly and that it was also deprived of its

<sup>454</sup> Forsyth & Pretorius *Suretyship* 161.

<sup>455</sup> Refer to *Devenish v Johnstone* (1847) 2 Menz 82 in Forsyth & Pretorius *Suretyship* 164.

<sup>456</sup> Forsyth & Pretorius *Suretyship* 163. See also Kopel *Business Law* 265.

<sup>457</sup> Forsyth & Pretorius *Suretyship* 163. See also Kopel *Business Law* 265.

<sup>458</sup> Forsyth & Pretorius *Suretyship* 163.

<sup>459</sup> Swart & Lombard (2015) 78/3 *THRHR* 525.

<sup>460</sup> Swart & Lombard (2015) 78/3 *THRHR* 525.

<sup>461</sup> 2014 4 SA 521 (WCC).

<sup>462</sup> *Tuning Fork* at para 43.

<sup>463</sup> 2013 (6) SA 471 (GNP).

<sup>464</sup> Act 108 of 1996.



right to claim payment of amount owed by the company to it..<sup>465</sup> The court stated that in order to enjoy the protection of section 25 of the Constitution, the right of the creditor must constitute 'property' within the meaning of section 25 of the Constitution.<sup>466</sup> Section 25 of the Constitution does not define the term 'property', but in the court's view the term is not limited to land.<sup>467</sup> In addressing the issue the court held that a claim for payment and the right to vote at a statutory meeting constitute property within the meaning of section 25 of the Constitution in that they are enforceable against specific parties.<sup>468</sup> Unfortunately, however, the applicant's constitutional challenge to section 153(1)(b)(ii) failed.<sup>469</sup>

### **3.10.2 Right of recourse against co-debtors**

A surety, who has also bound itself as surety for co-debtors, has a right of recourse against any of the co-debtors for the entire debt.<sup>470</sup> Where the surety claims from only one co-debtor, who pays it in full, it must cede its right of recourse against the other debtors, to that particular debtor.<sup>471</sup> Where the co-debtors are not liable *in solidum*,<sup>472</sup> the surety's claim will be limited to the creditor's respective portion of the total liability.<sup>473</sup>

### **3.10.3 Right of contribution from co-sureties**

The term co-sureties is used when two or more people undertake liability as surety for the same principal debt and obligation.<sup>474</sup> Co-sureties differ from ordinary sureties in that they have the benefit of division at their disposal, unless this has been excluded.<sup>475</sup> The surety who pays the principal debt to the creditor is permitted to claim a pro rata share of the debt from each co-surety.<sup>476</sup> Consequently, each co-

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<sup>465</sup> *African Banking* at para 38.

<sup>466</sup> *African Banking* at para 43.

<sup>467</sup> *African Banking* at para 44.

<sup>468</sup> *African Banking* at para 45.

<sup>469</sup> *African Banking* at para 46.

<sup>470</sup> Forsyth & Pretorius *Suretyship* 167.

<sup>471</sup> Forsyth & Pretorius *Suretyship* 167.

<sup>472</sup> For the whole amount.

<sup>473</sup> Forsyth & Pretorius *Suretyship* 167.

<sup>474</sup> Forsyth & Pretorius *Suretyship* 54. See also Kopel *Business Law* 264.

<sup>475</sup> Forsyth & Pretorius *Suretyship* 55.

<sup>476</sup> Nagel et al *Commercial Law* 332. See also Du Bois et al *Wille's Principles of South African Law* 1026; Kopel *Business Law* 266-267.

surety will be liable for its share of the debt (*singuli in solidum*)<sup>477</sup> unless otherwise stated.<sup>478</sup> Ordinarily no contractual relationship exists between co-sureties as it could have the effect that the surety who has paid more than its pro rata share of the debt will have a right of recourse, based on enrichment, against the other co-sureties.<sup>479</sup>

Co-sureties may, however, by way of a contractual agreement, agree on the method and degree to which each of them will be liable.<sup>480</sup> Therefore, the contractual provisions will be used to determine the liability of each of the co-sureties as each can be bound by separate suretyship agreements.<sup>481</sup> In *Executors Estate Watson v Huneberg & Leathern*<sup>482</sup> criteria were developed to determine if sureties are indeed co-sureties. The court stated that in order to determine if parties are co-sureties you must determine if an identical default by the principal debtor would cause them all to be liable for the debt.

### **3.10.4 Right of recourse against principal debtor**

Where the surety or co-surety has discharged the principal obligation to the creditor fully or in part, it will have a right of recourse against the principal debtor.<sup>483</sup> The surety will be entitled to recover the amount of debt paid plus any damages, loss, and expenses incurred as a result of the debtor not meeting its obligations<sup>484</sup>. The principal debtor and its surety are also permitted to conclude an agreement providing for the right of recourse of the surety, in the event it discharges the principal obligation of the principal debtor to the creditor.<sup>485</sup> Should the surety have taken cession of the creditor's actions<sup>486</sup> on or after payment of the principal debt, it will be able to enforce the creditor's rights against the principal debtor.<sup>487</sup> The right of recourse rises automatically, but is excluded should the surety fail to raise a valid

<sup>477</sup> Kopel *Business Law* 264 266-267. See also Forsyth & Pretorius *Suretyship* 55 138; Du Bois et al *Wille's Principles of South African Law* 1022.

<sup>478</sup> Du Bois et al *Wille's Principles of South African Law* 1022.

<sup>479</sup> Nagel et al *Commercial Law* 332. See also Kopel *Business Law* 266.

<sup>480</sup> Nagel et al *Commercial Law* 332.

<sup>481</sup> Nagel et al *Commercial Law* 332.

<sup>482</sup> 1915 NPD 571 at 577.

<sup>483</sup> Nagel et al *Commercial Law* 332. See also Kopel *Business Law* 265; Sharrock *Transactions Law* 769; Du Bois et al *Wille's Principles of South African Law* 1025.

<sup>484</sup> Kopel *Business Law* 265. See also Du Bois et al *Wille's Principles of South African Law* 1025; Forsyth & Pretorius *Suretyship* 116.

<sup>485</sup> Forsyth & Pretorius *Suretyship* 159. See also Kopel *Business Law* 265.

<sup>486</sup> Entitles the surety to have recourse against the principal debtor and co-surety's.

<sup>487</sup> Forsyth & Pretorius *Suretyship* 148.

defence (other than a personal defence) which the principal debtor had against the creditor, or where it failed to inform the principal debtor of the payment.<sup>488</sup>

### 3.11 Conclusion

The authors of *Caney's Law of Suretyship* provide a well-drafted definition of what is considered to constitute a contract of suretyship.<sup>489</sup> The purpose of a suretyship agreement is to protect the creditor against any loss associated with the principal debtor failing to meet any of its obligations.<sup>490</sup> This is achieved by the surety undertaking a conditional liability whereby it will only perform if the principal debtor fails to do so<sup>491</sup>

Suretyship can be distinguished from other contracts – such as indemnity or contracts of guarantee – on the basis of its accessory nature in that it requires a valid principal obligation between the debtor and creditor.<sup>492</sup>

In the sphere of business rescue proceedings, the accessory principle has given rise to numerous problems of interpretation and application when it comes to the liability of sureties.<sup>493</sup> When a business rescue plan fails to provide for suretyships, the common-law of suretyship will apply.<sup>494</sup> The common-law principles regarding suretyship provide that the liability of sureties is dependent on the existence of a principal debt.<sup>495</sup> This means that should the principal debt be compromised or extinguished, it will have a similar effect on the liability of the surety.<sup>496</sup> For instance, should a business rescue plan provide that a creditor's claim be paid partially in full and final settlement of the claim, the principal debt will be extinguished and the surety will escape liability.<sup>497</sup>

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<sup>488</sup> Sharrock *Transactions Law* 769. See also Nagel et al *Commercial Law* 332; Kopel *Business Law* 261.

<sup>489</sup> Forsyth & Pretorius *Suretyship* 28-9.

<sup>490</sup> Kopel *Business Law* 260.

<sup>491</sup> Kopel *Business Law* 260.

<sup>492</sup> Forsyth & Pretorius *Suretyship* 29-30.

<sup>493</sup> Swart & Lombard (2015) 78/3 *THRHR* 527.

<sup>494</sup> *Tuning Fork* at para 14 read with para 37. See also Naidoo A "Can you rely on your suretyship in business rescue?" available at <http://succeedblog.co.za/DMKisch/?cat=3> (accessed 9 June 2016).

<sup>495</sup> Swart & Lombard (2015) 78/3 *THRHR* 527.

<sup>496</sup> *Tuning Fork (Pty) Ltd T/A Balanced Audio v Greeff* 2014 4 SA 521 (WCC) at para 53. See also Swart & Lombard (2015) 78/3 *THRHR* 527.

<sup>497</sup> Delpont *Henochsberg on the Companies Act* 443.

The first contact between the common-law of suretyship and business rescue was in *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd & Others*<sup>498</sup> where the court held that the position of the sureties was unaffected by the provisions of the business rescue plan.<sup>499</sup>

In *Tuning Fork (Pty) Ltd t/a Balanced Audio v Greeff and Another*<sup>500</sup> this argument was rejected.<sup>501</sup> The court held that because the Act is silent on the right of a creditor to hold a surety of the principal debtor liable, the common law must be applied when assessing the surety's liability, unless the deed of suretyship or the business rescue plan state otherwise.<sup>502</sup> On the issue of the interaction of the common law and statute, it stated that a distinction should be made between the legal consequences dictated by a statute, and those arising under the common law.<sup>503</sup> This means that if the statute determines the position, it must be applied irrespective of the common-law provisions; but should the statute fail to govern a position, we must apply the common law.<sup>504</sup> In coming to his conclusion, Rogers J considered the decision in *Moti and Co v Cassim's Trustee's*<sup>505</sup> which relates to the accessory principal governing the discharge of the principal debtor by way of a release or compromise.<sup>506</sup> The majority in this case held that relieving the debtor of its debts would result in the surety also being released from its obligation even if the law does not so provide.<sup>507</sup>

In *ABSA Bank Limited v Du Toit and Others*<sup>508</sup> the court considered the accessory principle and made the following remarks: "A claim against a surety starts and ends with the principal obligation and once the principal debt is altered the accessory liability under the suretyship may also be regarded as having been altered".<sup>509</sup>

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<sup>498</sup> 2013 (6) SA 471 (GNP).

<sup>499</sup> *African Banking* at para 71.

<sup>500</sup> 2014 (4) SA 521 WCC.

<sup>501</sup> *Tuning Fork* at para 86.

<sup>502</sup> *Tuning Fork* at para 14 read with para 37.

<sup>503</sup> *Tuning Fork* at para 37.

<sup>504</sup> *Tuning Fork* at para 37. See also (2015) 78/3 *THRHR* 526.

<sup>505</sup> 1924 AD 720.

<sup>506</sup> *Tuning* case paras 54 & 55.

<sup>507</sup> *Tuning* at paras 54 & 55. See also Musesengwa (2015) February *Without Prejudice* 20.

<sup>508</sup> Refer to the discussion of this case under point 2.6.2 of this dissertation.

<sup>509</sup> Ford G & Kleitman Y "Business rescue and suretyships" available at <http://financialmarketsjournal.co.za/oldsite/19thedition/printedarticles/businessrescue.pdf> (accessed 10 June 2016).

Therefore, as can be seen from the above, the position is uncertain and unsatisfactory and can only be resolved by legislative reform or a judgment of the Supreme Court of Appeal.

## CHAPTER 4

### CONCLUDING REMARKS AND RECOMMENDATION

In this dissertation, I considered the liability of sureties before and after the adoption and implementation of a business rescue plan. From my evaluation of current legislation and case law, several shortcomings have been identified, as pointed out in my preceding chapters, as with regards to the regulation of sureties of companies during business rescue proceedings.

The conclusion reached is that the position of sureties is currently uncertain. This is due to, firstly; Chapter 6 of the Act not addressing the position of a surety for a company in business rescue and secondly; the divided approach of the courts on whether creditors can hold a surety of a debtor company liable.<sup>510</sup>

In an effort to address the current uncertainty, I recommend that the legislature should intervene and deal specifically with the issue of the liability of sureties as this will make the intention of the legislature known. This can be achieved by amending current legislation to incorporate the position of sureties during business rescue proceedings.

After considering the provisions of sections 311(3) of the Companies Act 61 of 1973 and section 155(9) of the current Companies Act<sup>511</sup>, I propose that the following provision should be added to Chapter 6 of the Act:

“Despite the wording and adoption of a business rescue plan and the provisions of section 154, the adoption of a business rescue plan does not affect the liability of any person who is a surety of a company in business rescue, unless the surety agreement specifically exclude the liability of the surety”.

Incorporating the suggested provision above will go far in providing greater legal certainty and clarity on the position of creditors against sureties in business rescue proceedings.

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<sup>510</sup> See for example the *obiter* remarks of the Supreme Court of Appeal in *New Port Finance Company (Pty) Ltd and Another v Nedbank Limited* 2016 (5) SA 503 (SCA) where the SCA doubted the correctness of the approach taken in *Tuning Fork (Pty) Ltd T/A Balanced Audio v Greeff* 2014 (4) SA 521 (WCC). Refer also to the discussion of these cases in my dissertation.

<sup>511</sup> Both sections contain provisions to the effect that an arrangement or compromise between a company and its creditors will not affect the liability of a surety of the debtor company.

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