There has been considerable controversy about the extent of the powers, and the extent of obligations of a business rescue practitioner in relation to a cession of book debts by the company in rescue.

This is an important issue in business rescue because most financially distressed companies have an overdraft facility with a bank which is secured by a cession of debtors. Many practitioners want or need to use the overdraft facility as working capital.

Cession (generally)

A cession is a legal act of transfer. It encompasses an agreement which provides that the transferor or cedent transfers a right to the transferee or cessionary. The principle is that the holder/creditor of a right can cede his or her claim to his or her own creditor in order to secure the debt which he or she owes. The primary function of a cession is to effect a substitution of creditors. The subject matter of the cession is personal rights and no real rights are transferred.

In practice, the process of a cession can be summarised as:

- Once a company is in default the secured creditor is usually entitled to notify the debtors to pay it directly (a kind of "perfection").
- The creditor then collects the payments straight from the debtors (that is, a practical "enforcement", though not by means of any court process) up to the amount of the company's outstanding debt.
- Usually the cession provides that once a company is in default, it may not use the proceeds of the ceded debt for any purpose other than repayment of the creditor until the company's debt is discharged (otherwise this form of security would be of little value).
- If the underlying debtor has not been notified of the security cession it may continue to pay the company and this will constitute a good discharge of its obligations under the debt.
- However, this does not necessarily translate into fulfilment of the company's obligations to the bank under the security cession, as the bank is still entitled to those funds for as long as the company's debt to it is outstanding.
- If the company continues to collect the debtors, it is obliged to pay them over to the bank.
There are two theories of a security cession, the pledge theory and an out-and-out cession with undertaking to re-cede (reversionary rights). The distinguishing element between a "pledge" and "out-and-out cession" is that:

- pledge is governed by the general principles of the law of property, and more specifically the law of real security; and
- in a pledge the creditor obtains quasi possession (control);
- an "out-and-out cession" is governed by the law of contract where the right in itself is transferred coupled with an agreement (and agreement to re-cede).

Usually a cession of book debts takes place in terms of an out-and-out security cession. The only time a pledge construction will be upheld is when the possibility of an out-and-out security cession is expressly excluded.

The cessionary in this type of cession is not required to give notice to the cedent’s debtors. The cessionary merely holds this cession as security, extinguished book debts being replaced by new ones all the time. In Grobbelaar v Oosthuizen 2009 (5) SA 500 (SCA) the court held that in a case of an outright cession, the cedent loses all his rights by transferring those rights to a cessionary and nothing remains vested in the cedent after cession (see paragraph 8). This was supported in the judgement of Kritzinger and Another v Standard Bank of South Africa (3034/2013) [2013] ZAFFHS 215 (19 September 2013) (the Kritzinger case).

In both cases, should the cedent fail to pay the secured debt on the due date agreed upon by the cedent and cessionary, the cessionary is then entitled, without prior judgement, to redeem the debt owed to it. Usually any surplus recovered will be handed over to the cedent. We now turn to the question of the applicability of section 134 of the Companies Act 71 of 2008 cessions of book debts.

Section 134(3) of the Companies Act provides that:

"if, during a company’s business rescue proceedings, the company wishes to dispose of any property over which another person has any security or title interest, the company must –

(a) obtain the prior consent of that other person, unless the proceeds of the disposal would be sufficient to fully discharge the indebtedness protected by that person’s security or title interest; and

(b) promptly –

(i) pay to that other person the sale proceeds attributable to the property up to the amount of the company's indebtedness to that other person; or

(ii) provide security for the amount of those proceeds, to the reasonable satisfaction of that other person."
In other words, the business rescue practitioner may not dispose of or encumber property without the secured creditor’s consent, unless the proceeds are sufficient to discharge the indebtedness to the secured creditor and are actually paid to it immediately. It is our view that section 134 is not applicable to a cession of debtors. A debt owing to the company in rescue is not “property” within the meaning of section 134 because:

- nobody is in possession of incorporeal property (that is, the debtor’s book);
- the creditor owns the right to claim the debt but cannot own the debtor;
- with reference to “sale proceeds” you do not sell a debt, you cede it.

Even if a debt constituted property for the purposes of section 134, the *pactum de non cedendo* would prevent the business rescue practitioner from disposing of the book debts without the bank’s consent. Section 134(3) is inapplicable to a standard cession of book debts because the definition of “security” in section 1 of the Insolvency Act is “property of an insolvent estate over which the creditor has a preferent right by virtue of any special mortgage, landlord’s legal hypothec, pledge or right of retention [lien]”.

Security for a debt can only be held over the property of another person, not over your own property. The bank does not have security over the ceded debt, it “owns” the ceded debt. An analogous situation is found in the case of a notarial general bond – the bank can only enjoy the security of the bond over movable assets which belong to the bank’s debtor, but if the bank takes ownership of the assets under the *paratie executie* clause, the security falls away because the bank is now the owner of the underlying asset.

A possible reason for the confusing wording is because there are two debts encompassed in section 134(3), which need to be distinguished:

- The ”property” which is intended to refer to the debt owed by the debtor of the company in rescue (to the cedent).
- The subject matter of the “security”, which is intended to refer to the debt owed by the company to the bank (to the cessionary).
- Bank representatives sometimes suggest that the debtors of the cedent remain the property of the bank in that the funds paid by that debtor retain their character as an asset of the bank, even after payment by the cedent’s debtor. This is not correct.
- Once a debtor pays into the company’s bank account, the company’s obligations in terms of the cession have been discharged for that debtor.
- The funds paid by the cedent’s debtor into the cedent’s bank account become commingled with other funds in the account.
- Receipt of the payment does not transfer ownership to the bank, there is only a change in the company’s account balance. The company’s obligations to the bank are then regulated by the terms of the facility agreement. Payment out of the company’s bank account, even if from the proceeds of the debtors, does not constitute a disposition of property for the purposes of section 134(1)(a).
Can a cession of book debts be suspended in terms of section 136(2)(a)?

Section 136(2)(a) of the Act entitles a practitioner to suspend any obligation of the company that arise under any agreement and to which the company was a party at the commencement of business rescue proceedings.

This clause confers wide powers on practitioners, and in most cases would permit the practitioner, for example, to suspend a company’s payment obligations under a facility agreement. It is noted that the practitioner can only suspend obligations and not the entire contract. It is borne in mind that contracts are, in general, a bundle of rights and obligations. What the statute does not say is that the practitioner is empowered to suspend the rights of third parties. A cession of book debts confers rights on the bank (more generally on the cessionary) without a corresponding obligation on the part of the cedent.

In our view, it is clear that business rescue practitioners may not lawfully suspend a cession of book debts (or for that matter any security right which a bank may enjoy). In our opinion, there is nothing untoward about a practitioner collecting book debts from the company’s debtors into the company's bank account held with the cessionary bank, and then using the proceeds to pay the company’s operational costs and costs of business rescue. However, it is entirely inappropriate for the practitioner to divert the funds collected from debtors to an account with another bank.

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