Sureties and business rescue

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A pertinent issue that has arisen in the context of business rescue is whether, and when, a creditor of a company in business may pursue a surety.

Applicable legislation

Section 154 of the Companies Act 71 of 2008 provides that a business rescue plan (BR plan) may provide that a creditor, who has acceded to the discharge of the whole or part of a debt owing to that creditor, will lose the right to enforce the debt or part of it. Furthermore, if a BR plan has been approved and implemented, a creditor is not entitled to enforce any debt owed by the company immediately before the beginning of the business rescue process, except to the extent provided for in the BR plan. Thus the legislation contemplates a compromise of claims of creditors against a debtor in business rescue.

Chapter 6 of the Act dealing with business rescue does not address the position of a surety for a company in business rescue. In contrast, section 155, which regulates a statutory compromise with creditors clearly provides in subsection (9) that such compromise does not affect the liability of a person who is a surety of the company.

Legal position prior to the adoption of a business rescue plan

In Investec Bank v Andre Bruyns 2012 (5) SA 430 (WCC) it was held that the moratorium on legal proceedings in respect of a company in business rescue did not extend to the sureties of the company. The moratorium in favour of the company in business rescue is a personal defence (a defence in personam) available only to the company, and a creditor will thus be able to enforce payment of the debt against a surety during business rescue proceedings. A defence in personam would have the effect that the creditor can still sue the surety, as the principal debt continues to exist. The result is that the contract of suretyship would also continue to exist as a contract. Unless the contract of suretyship provides otherwise, the surety then has a right of recourse against the principal debtor.

In African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd & Others 2013 (6) SA 471 (GNP), the court held that the liability of sureties for the company’s debts is not affected and they remain liable. No reason for this view was given.
However, the above legal position only applies to the situation where no BR plan has as yet been approved. The possibility that a BR plan could be approved and implemented at a later stage, and in terms of which the company in business rescue could be wholly or partly released from its debts in turn affects the right of a creditor to claim payment of a debt that is due and payable from the surety.

**Legal position after the adoption of a business rescue plan**

In *Tuning Fork v Greeff 2014 (4) SA 521 (WCC)*, a creditor who had been paid out 28 cents in the rand by a company in full and final settlement of its indebtedness following a business rescue compromise, sought to recover the remainder of the company’s debt from the sureties. As the Act is silent on this point, the court accordingly applied the common law relating to sureties. The common law states that, where a debtor is released from its liability in respect of a debt, so too are its sureties in respect of that debt.

The court stated that “if a business rescue plan provides for the discharge of the principal debt by way of a release of the principal debtor, and the claim against the surety is not preserved by such stipulations in the plan as may be legally permissible, the surety is discharged”. It stated that one of the general principles of our law of suretyship is if the principal debt is discharged by a compromise with or release of the principal debtor, the surety is released, unless the deed of suretyship provides otherwise. As a result of that full and final settlement, the company’s indebtedness to the creditor had been extinguished and it followed that its sureties were equally free from liability.

In *Absa Bank Limited v Du Toit and Others 7311/13* the court, for purposes of a bona fide defence in an application for summary judgment, decided that a provision in the BR plan for “full and final settlement of its indebtedness” results that the principal debt is extinguished. This was further supported by the fact that the BR plan did not provide for the continued enforcement of the principal debt.

In *DH Brothers Industries (Pty) Ltd v Gribnitz NO & Others 2014 (1) SA 103 (KZP)* the court held that if the BR plan provided for a discharge of the main debt (to which the creditor had to agree, that is, "acceded"), it had the effect as stipulated in the common law that the liability of a surety for that debt would also cease to exist.

In the case of *New Port Finance Company (Pty) Ltd v Nedbank Ltd [2015] 2 All SA 1 (SCA)*, the court held that, provided the deed of suretyship contains a clause that affords the creditor a right to pursue the surety, even if the principal debt has been compromised, this will override a compromise in the business rescue plan.

The effect of the case law discussed is that creditors will have no recourse against sureties for the recovery of the balance of the principal debt of a company in business rescue where a BR plan is adopted that provides for a compromise of claims and where the suretyship agreement is silent.
on the enforceability of the surety in the event of the company going into business rescue. In other words, where both the BR plan and the suretyship agreement are silent on the effect of business rescue and a compromise following such proceedings on sureties, the common law prevails.

Accordingly, it is crucial from a creditor’s perspective that the suretyship agreement provides adequately for the rights of the creditor. This can be done in two ways, which are not mutually exclusive. One is by stating expressly that should the company go into business rescue this does not detract from the right of the creditor to recover from the surety the full amount for which it is bound under the suretyship. The other is by incorporating a guarantee into the suretyship document. A guarantee creates a principal obligation, not an ancillary obligation and, therefore, would not automatically be extinguished by a compromise of the principal debt.

In addition, it is prudent that the creditor’s rights in respect of sureties are properly canvassed and specifically preserved in the BR plan. The surety’s rights of recourse against the company should the creditor be paid under the suretyship also need to be dealt with. It will not help the company’s overall position if the liability to the creditor is simply replaced by an identical liability in monetary terms to the surety who has paid.

There may be commercial reasons why a creditor holding a suretyship for the debts of a company in rescue might not want to enforce it (for example if the surety is a director of the company whose continued cooperation is essential to the survival of the business), but creditors should be alert to the need to protect their rights under those suretyships.

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