# THE SUPREME COURT OF APPEAL
# OF SOUTH AFRICA

Reportable
CASE NO 445/2004

In the matter between

BOE BANK LIMITED Appellant

and

J J BASSAGE Respondent

Coram: Mpati DP, Scott, Zulman, Navsa and Cloete JJA
Heard: 10 March 2006
Delivered: 31 March 2006

*Summary*: The effect of a secured creditor's election to rely upon its security when proving its claim in terms of s 89(2) of the Insolvency Act 24 of 1936 is not to release a surety to the creditor for the shortfall in the claim.

**Neutral citation: This judgment may be referred to as *BOE Bank Limited v J J Bassage* [2006] SCA 50 (RSA)**

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JUDGMENT

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ZULMAN JA

[1] The issue in this appeal is whether the appellant has a claim against the respondent as surety for the balance of a debt of Zandills Shoe Manufacturers Limited (in liquidation) ('the Company'), when payment of the balance cannot be enforced against the Company by the appellant because it has elected to follow the procedure set out in s 89(2) of the Insolvency Act 24 of 1936 (the Insolvency Act). The High Court of the Natal Provincial Division (Niles-Duner J) dismissed the claim. The appeal is with the leave of the court *a quo*.

[2] The issue arises in the following manner:

1. The Company was indebted to NBS Bank Limited (NBS), the predecessor in title of the appellant, in terms of two action bond agreements.
2. The indebtedness was secured by two covering mortgage bonds over immovable property owned by the Company.
3. On 3 July 1996 the respondent bound himself in writing as surety and co-principal debtor, renouncing the benefits of excussion and division, to NBS for the debts of the Company.
4. The Company was finally wound up on 12 May 2000. On 18 May 2000 three joint liquidators were appointed.
5. On 26 October 2000 the appellant deposed to an affidavit in terms of s 44(4) of the Insolvency Act in accordance with Form C to the First Schedule of the Insolvency Act in proof of a claim against the Company of R1 972 721,06 plus interest at a margin of 0,50 per cent above the prime rate to date of payment. The affidavit states:

> '(3) That no other person besides the said Company is liable (otherwise than as surety) for the said debt or any part thereof.
>
> (4) That the said Creditor has not, nor to my/our knowledge on my/our

behalf received any security for the said debt or any part thereof save and except:

**1st and 2nd mortgage bonds over Rem of Lot 1571 Pietermaritzburg situate in the city of Pietermaritzburg which security has been valued at R800 000.**

(5) . . .

(6) That the said Creditor relies solely on the realisation of its security for satisfaction of its claim.'

6. By virtue of resolutions adopted at a second meeting of creditors of the Company held on 27 October 2000 the liquidators were:

'[A]uthorised and empowered to abandon any assets which are subject to any right of security to the creditor concerned, in full settlement of the creditor's claim or at an agreed valuation as the case may be, provided the liquidators are satisfied that no benefit could accrue to the concurrent creditors of the Company were the asset in question to be realised in the ordinary course, subject to the creditor concerned paying the costs of realisation attributable to its security in terms of s 89(1) of the Insolvency Act.'

7. On 14 November 2000 the liquidators and the appellant concluded an agreement entitled 'Deed of Abandonment' in terms of which the Company's immovable property was abandoned by the liquidators to the appellant for a consideration of R800 000 including value added tax.

8. At a special meeting of creditors held on 26 January 2001 the appellant proved its claim of R1 972 721.06 plus interest. The appellant submitted the affidavit dated 26 October 2000 which is referred to in sub-paragraph 5 above in support of the claim.

9. On 24 April 2001 the appellant sued the respondent as surety for payment of the sums of R623 891,13 and R385 897,40 plus interest on these amounts which represented the net shortfall of the amounts which the appellant had recovered from the company in liquidation.

[3] By virtue of s 366(1) of the Companies Act of 1973 (the Companies Act) the provisions of the Insolvency Act regarding the proof of claims are *mutatis mutandis* applicable to the proof of claims against companies in liquidation. In terms of s 342 of the Companies Act, the provisions of the Insolvency Act regarding contributions by creditors towards any costs incurred in the winding-up of a company, apply to the winding-up of a company.

[4] Section 44(4) of the Insolvency Act requires that a claim must be proved by affidavit in a prescribed form corresponding substantially with form C or D of the first schedule of the Insolvency Act. It must, inter alia, be stated in the affidavit whether the creditor holds security for his claim, the nature and particulars of that security and the amount at which the security is valued by the creditor.

[5] Section 89(2) of the Insolvency Act provides that:

> 'If a secured creditor (other than a secured creditor upon whose petition the estate in question was sequestrated) states in his affidavit submitted in support of his claim against the estate that he relies for the satisfaction of his claim solely on the proceeds of the property which constitutes his security, he shall not be liable for any costs of sequestration other than the costs specified in subsection (1), and other than costs for which he may be liable under paragraph (a) or (b) of the proviso to section *one hundred and six*.'

[6] The respondent's counsel submitted that once the appellant proved its claim and relied solely on its security, it had no further claim that was enforceable against the company; and that it followed that the respondent as surety was discharged from any liability to the appellant on the claim. For this submission the respondent's counsel relied in particular on the following dictum

of Galgut AJA in *Bank of Lisbon and South Africa Ltd v The Master*[1]

> 'A creditor seeking to prove his claim has to comply with s 44(4). If he alleges he holds security he must, in terms of that section, furnish the nature and particulars thereof to prove that his security exists. If he then acts in terms of s 89(2), and declares that he relies for the satisfaction of his claim solely on the proceeds of the property which constitutes '*his* security', the section provides, save for certain exceptions not here relevant, that he shall not be liable for any costs of sequestration. The italics are mine.
>
> Sections 44(4) and 89(2) must be read together. The intention is clear. A creditor who claims that he is a secured creditor and who does not wish to share in the free residue and who looks only to the proceeds of his security is not liable for any costs of sequestration, nor can he receive more than his security or its proceeds, whether or not there is a free residue. "His security", i.e. the security designated as such by the creditor, may prove to be valueless or may have ceased to exist. There is nothing in the wording of s 89(2) which suggests that that fact will render such a proved creditor liable for any costs of sequestration. As indicated above, the whole purpose of the section is to enable a creditor, who believes when lodging his claim that his security has a value, to limit his claim to the value of his security and to free him from liability for costs. If it should transpire that his security has become valueless the basis on which he proved his claim would fall away. He would not have a claim against the estate. The position cannot be different in the case of a creditor who *bona fide* believes that he holds security and specifically limits his claim and his potential liability. He for all practical purposes ceases to be a creditor of the estate. The bank was in fact in that position.'

Remarks to similar effect were made in *Absa Bank Ltd v The Master*. [2]

In both cases the liability of a surety for the debts of the company being wound up were not in issue. The comments were directed to the position of a secured creditor who elects not to share in the free residue and looks only to the proceeds of its security for the satisfaction of its claim. The dictum of Galgut AJA merely means that any shortfall between the eventual net amount

[1] 1987 (1) SA 276 (A) at 287G-288C.
[2] 1998 (4) SA 15 (N) at 29J-31B.

recovered by a creditor from the proceeds of its security cannot be recovered from, or is not enforceable against, the company or paid out to the creditor from any free residue. The words, 'He for all practical purposes ceases to be a creditor of the estate' must be read in their context. They do not mean that the debt is extinguished or wiped out entirely for all purposes, more particularly for the purposes of enforcing a claim for any shortfall, for example against a surety.

[7] Consistent with what was held in *Bank of Lisbon*, the liquidation and distribution account and encumbered asset account shows the abandonment of the company's immovable property to the appellant in an amount of R800 000 and confines the award to the appellant (R76 535,78) to the surplus on the account without any concurrent claim. The account nowhere states that the balance of the claim has been abandoned or it no longer exists. It merely reflects the fact that the appellant has no concurrent claim to any part of the free residue.

[8] Section 89(2) of the Insolvency Act does not state that the effect of a creditor who elects to rely on its security in proof of its claim results in the claim being extinguished entirely. The election is merely an election to execute on the claim or to prove the claim in a certain way. The object of the section is to confer a benefit on a secured creditor; it enables it to recover the value of its security without rendering itself liable for the costs of sequestration. The section goes no further than that. There is nothing to justify the construction that a creditor by electing to rely solely on its security, abandons or waives the balance of the claim and is thereby precluded from proceeding against a surety for the balance. Indeed, if such a far reaching consequence had been intended by the legislature it would have said so in unequivocal terms. The section means no more than that a creditor may limit the extent to which he will participate in the assets of the insolvent estate to the value of the asset which is his security. Once having made that election he is bound by it; he may not participate in the

free residue even if his security should prove to be without value. Both the *Bank of Lisbon* and *Absa Bank* cases decide no more than this. But this does not mean the balance of the claim no longer exists or has been waived. It remains extant. There is no good reason why it cannot be enforced against a surety who has waived the defence of excussion as is the position in this case.

[9] It is well established that if a creditor waives a portion of the debt, the surety is to that extent discharged.[3] In the present matter there was no intention on the part of the appellant to waive the debt to the extent that it exceeded the proceeds of the realisation of the security. Nor in my opinion does s 89(2) effect such a waiver. The operation of the section was to bring about a *pactum de non petendo* in terms of which the appellant agreed not to proceed against the company for the balance of its claim. It is true that the claim for the balance became unenforceable against the company, but the consequence is not (as the respondent's counsel submitted it was) that the suretyship became unenforceable. An unenforceable debt (provided it does not arise from a prohibited transaction) is a natural obligation which is capable of supporting a suretyship.[4]

[10] Scott JA aptly describes the typical surety in modern society in these terms in *Jans v Nedcor Bank Ltd*[5] (a case dealing with the question whether interruption or delay in the running of prescription in favour of the principal debtor interrupts prescription in favour of the surety):

> 'The typical surety in modern society is one who binds him- or herself as co-principal debtor and guarantees the debts of a company or close corporation which has little in the way of share capital or assets but is dependent on credit in order to conduct its business. More often than not the business is that of the surety or a spouse who for

[3] See for example *Moti and Co v Cassim's Trustee* 1924 AD 720 at 737.
[4] C F Forsyth & J T Pretorius *Caney's The Law of Suretyship* p 38 and authorities cited in n 17, including Voet *ad Pandectas* 46.1.9, Gane's translation vol 7 p 22; Wessels *The Law of Contract* 2 ed paras 1268 and 1276.
[5] 2003 (6) SA 646 (SCA) para 30 at 661I-662B.

> various reasons chooses to conduct it through the medium of a company or close corporation with limited liability. A creditor will ordinarily refuse to afford credit to such a legal *persona* in the absence of a personal suretyship and few businesses can operate successfully without credit. The very existence of the debt is therefore dependent upon the existence of the suretyship while the object and function of the latter is, of course, to ensure proper payment of the former.'

It would not make sound commercial sense if it were to be held that a creditor who elects to rely on its security in proof of its claim thereby and without more waives or abandons any rights that it has against the surety.

[10] If one were notionally to think away the insolvency of the company, then if the appellant had proceeded against the company, relying upon the mortgage bonds for recovery of what the company owed it, and had obtained a judgment against the company but upon issuing a writ had recovered only half of the claim, the appellant would obviously not have deprived itself of its right to proceed against the respondent for the balance of its claim. The position is no different in principle because the company is insolvent and the appellant has elected to prove its secured claim in terms of s 89(2).

[11] It is of some significance that s 129(3)(d) of the Insolvency Act specifically provides that rehabilitation does not in any way affect the liability of a surety for the insolvent. Similarly a statutory composition under s 120(3) of the Insolvency Act does not release sureties. Section 311(3) of the Companies Act provides that no compromise or arrangement shall affect the liability of any person who is a surety for the company in question.

[12] It was also argued on behalf of the respondent that the consequence of the deed of abandonment and subsequent proof of its claim against the company which resulted in the appellant having no further claim against the company,

deprived the respondent as surety of his right of recourse against the company as principal debtor, if he paid the appellant the balance of the claim. The argument is not sound. On insolvency of the company the respondent, insofar as he had not paid the appellant's claim, had a conditional or contingent claim against the debtor's estate.[6] If the respondent pays the appellant the unsatisfied shortfall of the appellant's claim, he would then be entitled to prove a concurrent claim in the insolvent estate.[7] It would not be open to the liquidators effectively to raise against the respondent the fact that the appellant, in proving its secured claim, had limited its claim to the proceeds of the security abandoned to it.

[13] I am accordingly of the view that the court *a quo* erred in finding that the appellant in limiting its claim to the value of its security had abandoned the unsatisfied balance of its claim against the company, with the result that the indebtedness of the company was extinguished to that extent and with the further consequence that the respondent was released as surety to the appellant.

[14] The court *a quo* directed the appellant to pay inter alia the costs occasioned by the postponement of the matter on 26 May 2003. There was no basis for the trial court to deprive the appellant of those costs. The matter had been set down for hearing on that date. The respondent then amended his plea. The amendment formed the basis on which the matter was eventually argued and decided. The appellant was entitled to a proper opportunity to consider its position in respect of the amendment and was correctly granted a postponement for such purpose.

[15] Subsequent to the judgment of the court *a quo*, the parties agreed that in

[6] Forsyth & Pretorius (supra n 4) at 167 and the authorities referred to in footnotes 84 – 86.
[7] *Taylor & Thorne NNO v The Master* 1965 (1) SA 658 (N) 611A-H and Forsyth & Pretorius (supra n 4) 157-158.

the event of this court upholding the appeal, there should be judgment in favour of the appellant in the sum of R550 000,00 together with interest thereon at the rate of 0,5 per cent per annum above the prime rate charged by the appellant from 12 May 2000 to date of final payment.

[16] In the circumstances the following order is made:

1. The appeal is upheld with costs, such costs to include costs of two counsel.
2. Paragraphs 1 and 2 of the judgment of the court *a quo* are set aside.
3. It is declared that the respondent is liable to the appellant as surety in terms of the deed of suretyship executed by him in favour of the appellant on 3 July 1996 pursuant to which the respondent bound himself as surety and co-principal debtor with Zandills Shoe Manufactures Ltd (in liquidation) for amounts due by the company to the appellant's predecessor in title, NBS Bank Ltd.
4. The respondent is directed to pay the appellant R550 000,00 together with interest thereon at the rate of 0,5 per cent per annum above the prime rate charged by the appellant from 12 May 2000 to date of final payment.
5. The respondent is directed to pay the appellant's costs of suit including the costs occasioned by the postponement on 26 May 2003 and such costs shall include the costs of two counsel where employed.

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R H ZULMAN
JUDGE OF APPEAL

CONCUR: ) MPATI DP
) SCOTT JA
) NAVSA JA
) CLOETE JA

NAVSA JA:

[1] I have had the benefit of reading the judgment of Zulman JA. I agree with the conclusion and the order proposed, but adopt a different approach which is set out hereafter.

[2] In 6 *Lawsa* (reissue) para 216 the following appears:

'**Extinction of principal obligation** Since the obligation between a creditor and a surety is always accessory to the principal obligation between the creditor and the principal debtor, extinction of the principal obligation, in any way whatsoever, serves to discharge (release) the surety. An exception to this general rule exists where the principal debt is extinguished by the rehabilitation of an insolvent principal debtor, and also where the principal debtor is a company which is liquidated and dissolved.'

In support of this proposition two decisions of this court are referred to, namely, *Traub v Barclays National Bank Ltd, Kalk v Barclays National Bank Ltd* 1983 (3) SA 619 (A) and *Norex Industrial Properties (Pty) Ltd v Monarch SA Insurance Co Ltd* 1987 (1) SA 827 (A).

[3] In the *Traub* matter, Botha JA said the following (at 634A):

'If the principal debtor is a natural person and he dies, his surety remains liable to his creditor; and a surety for a company remains liable to its creditor if it is liquidated and dissolved under s 419 of the Companies Act.'

In that matter the appellants had been sureties for a company that had lost all of its assets and was subsequently deregistered.

[4] In the *Norex* matter, Botha JA said the following (at 840F-H):

'When a surety binds himself to a lessor "for the due fulfilment by the lessee of all its obligations in terms of the . . . lease", and the lessee goes insolvent, in consequence of which the liquidator terminates the lease and the lessor suffers a loss in respect of the rental, that can assuredly not be regarded as a cause foreign to the lease. On the contrary it seems to me to be apparent that that was exactly the kind of eventuality against which the lessor would have wished to protect himself by procuring the suretyship, and in respect of which the surety bound himself to indemnify the lessor.'

[5] The insolvency process is to enable creditors to institute claims against the debtor. The Insolvency Act provides the means for them to do so. The purpose of s 89(2) is set out in the judgment of Zulman JA. In my view, the creditor is, for the reasons set out in the *Traub* and *Norex* cases, clearly entitled to proceed against the surety for the balance of what is owed to it. As pointed out in the *Norex* matter, insolvency is one of the reasons for which a creditor would require security such as a suretyship. This makes sound commercial sense. The liquidation process is one through which creditors seek as best they can to obtain what is due to them from the principal debtor. It is in that context that the *dicta* in the *Bank of Lisbon* and *Absa Bank* cases referred to in the judgment of Zulman JA should be seen.

[6] In my view, on the basis of the *Traub* and *Norex* cases and the reasoning set out above, the issues of waiver and abandonment, or extinction of the debt insofar as the surety (in this case the respondent) is concerned do not arise. Put

simply, and restating what is set out in those two cases, the liquidation process does not extinguish the surety's indebtedness.

M S NAVSA
JUDGE OF APPEAL