BANKING LAW UPDATE

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A SIGNIFICANT CHANGE TO THE *IN DUPLUM* RULE

On 24 March 2015, the Constitutional Court developed the common law regarding the *in duplum* rule in its judgment in *Paulsen and Another v Slip Knot Investments 777 (Pty) Limited* 2015 (3) SA 479 (CC). The development involves a fundamental change of critical importance to banks and any litigation they may currently be involved in.

The *in duplum* rule has ancient roots in South African law and is so embedded that banking practice cannot alter it, nor can contracting parties waive its application. Simply put, the rule provides that arrear interest stops accruing when the sum of the unpaid interest equals the amount of the outstanding capital. At the time, the purpose of the introduction of the *in duplum* rule was to prevent lenders from exploiting borrowers and to cap the interest creditors could claim from them.

Until the judgment in Paulsen the *in duplum* rule had one exception, namely that the prohibition against claiming interest in excess of the capital fell away when a creditor instituted proceedings to recover the debt and the interest. This meant that once litigation was initiated, interest began to run again on the capital outstanding, which additional interest the creditor was entitled to recover from the debtor. In effect, interest would then run at the agreed, or *mora*, rate for as long as the litigation persisted. Once judgment was granted for those amounts, interest would also run on that 'judgment debt' until the date of payment thereof by the judgment debtor, subject again to the *in duplum* rule. This allowed creditors to recover interest in excess of the amount of the capital if the creditor had to resort to instituting litigation to recover a debt owing.

However, in what will no doubt be labelled a consumer friendly judgment, the Constitutional Court has now abolished the exception to the *in duplum* rule while litigation persists. In doing so, the Court ruled that the Supreme Court of Appeal was incorrect when it affirmed the exception in *Standard Bank of South Africa Ltd v Oneanate Investments (Pty) Ltd* 1998 (1) SA 811 (SCA). Madlanga J and Moseneke DCJ, in separate but concurring judgments, agreed that the exception to the *in duplum* rule was out of touch with socio-economic realities, contrary to public policy and offended the right of access to courts, enshrined in s34 of the Constitution. However, in a third dissenting judgment, Cameron J strongly affirmed the exception to the *in duplum* rule, noting its strong legal heritage and the important role it played in deterring dilatory debtors from delaying payment of their debts.

The effect of the *Paulsen* judgment is thus that until judgment (after which interest will once again run on the 'judgment debt'), banks will only ever be able to recover 1) the capital advanced to a debtor and 2) the interest equal to that capital amount and no more.

Post-judgment interest

Our previous alert on *Paulsen* did not deal with additional post-judgment interest, which creditors may be able to recover (which interest will in turn be limited to an amount equal to the whole of the judgment debt).

As Madlanga J noted, it is settled law that the *in duplum* rule permits interest to run anew from the date that the judgment debt is due and payable [Para. 96]. In this regard, Madlanga J considered three practical questions regarding post-judgment interest, two of which were interlinked.

The first question was whether post-judgment interest runs on the whole of the judgment debt or only the original capital amount of the loan. The second was whether the *in duplum* rule capped the running of such additional interest at double the sum of the whole of the judgment debt or at double the sum of the original capital amount of the loan. In this regard the Constitutional Court affirmed the Supreme Court of Appeal's reasoning that "…interest runs on – and is limited to an amount equal to – the whole of the judgment debt, including the portion which consists of previously accrued interest." [Para. 100]

Finally, the Constitutional Court considered the rate at which interest ran, that is, whether interest would run at a contractually agreed rate or at the statutorily prescribed rate of

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interest post-judgment? In keeping with previous case law on this point, the Constitutional Court affirmed that post-judgment interest runs at the rate agreed upon and not the statutorily prescribed rate of interest (now 9%).

Crucially, the reprieve granted to debtors by the Constitutional Court in *Paulsen* will have an immediate effect on all current and pending litigation, except those matters that have been finalised with no possibility of appeal.

Leave to appeal to the Constitutional Court in non-constitutional matters

Prior to the enactment of the Constitution Seventeenth Amendment Act, 2012, the Constitutional Court's jurisdiction was constrained - in s167(3) of the Constitution of the Republic of South Africa, 1996 - to constitutional matters and issues connected with decisions on constitutional matters. However, the new s167(3)(b) has extended the jurisdiction of the Constitutional Court to include any other matter, "if the Constitutional Court grants leave to appeal on the grounds that the matter raises an <u>arguable point of law of general public importance which ought to be considered</u>" by the Constitutional Court [our emphasis added]. In other words, the Constitutional Court may now choose to decide matters that were previously regarded as 'non-constitutional' [Para. 13 – 16].

Notably, in their application for leave to appeal, the Paulsens did not raise any constitutional matters, instead resting their case for leave to appeal solely on the assertion that the matter raised arguable points of law of general public importance which ought to be considered by the Constitutional Court. *Paulsen* was therefore an opportunity for the Constitutional Court to determine the scope of the new s167(3)(b)(ii).

In short, the Constitutional Court held that in determining whether a point of law is arguable, it must fulfil two criteria, namely a) the point must be one of law (and not fact) and b) that it must have some prospects of success. Ultimately, Madlanga J held that whether a point of law is arguable will depend on the circumstances of each case. Regarding what constitutes a matter of public importance, the Constitutional Court held that to fulfil the criterion the matter must "… transcend the narrow interests of the litigants and implicate the interest of a significant part of the general public." [Para. 22-23 and 25-26]

Furthermore, in regard to the question of whether the interests of justice factor plays a role in the determination of whether leave to appeal should be granted in regard to 'non-constitutional' matters, Madlanga J, held that "[i]f – for whatever reason – it is not in the interest of justice for this Court to entertain what is otherwise an arguable point of law of general public importance, then that point is not one that 'ought to be considered by [this] Court.'" [Para. 30] It is evident then that it would serve an applicant for leave to appeal well to state - and to state clearly - that the interests of justice favour the hearing of the matter.

Madlanga J accordingly held that there were various arguable points of law raised by the Paulsens including *inter alia* whether the *in duplum* rule applies during the pendency of litigation. To boot, a determination in this respect would have a significant impact on the general populace.

Notably, Madlanga J's comments regarding the interpretation of the National Credit Act, No 34 of 2005 in paragraph 27 seem to suggest that the Constitutional Court will entertain appeals regarding the interpretation of the NCA in future, premised on the fact that it "regulates commercial activity undertaken by many people and institutions on a daily basis."

Callum O'Connor

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1st in M&A Deal Flow, 1st in M&A Deal Value, 1st in Unlisted Deals - Deal Flow.
2012
1st in M&A Deal Flow, 1st in General Corporate Finance Deal Flow,1st in General Corporate Finance Deal Value,1st in Unlisted Deals - Deal Flow.
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AMERICAN COURTS ARE INDEED THE LONG ARM OF THE LAW

In a recent decision that is now on appeal, a New York Federal Judge ordered a Spanish Bank that maintained a New York branch to make enquiry of "all branches, within and without New York State" for account information that would be relevant to a third-party's execution and judgments against the Republic of Cuba. The court, in rejecting the bank's jurisdictional arguments, held that the bank's registration with the New York Department of Financial Services as a foreign banking corporation was a sufficient jurisdictional connection with New York to require a global compliance by the bank with the plaintiff's discovery request. The decision in Vera vs Republic of Cuba, if it withstands the appeal, could have long lasting implications for international banks that maintain a presence in New York.

The Vera Judgment Enforcement Proceeding

The Vera judgment is a judgment enforcement proceeding brought in New York in which the plaintiffs sought to execute a judgment they previously obtained against the Republic of Cuba against blocked funds held by the respondent banks relating to electronic funds transfers sent from Cuba to third parties. The Vera plaintiffs also served broad information subpoenas on certain banks in search of additional Cuban property held by the banks "in their New York branches and elsewhere".

Most of the banks named in the suit reached an agreement with the plaintiffs that provided for turnover of blocked funds in their possession but also protected the banks against potential double liability if they were later sued by persons claiming an interest in the funds. Two banks, including a Spanish bank, did not agree and claimed that the New York court lacked personal jurisdiction over them for these purposes in view of a recent Supreme Court decision in Daimler AG v Bauman, in which the High Court held that the United States courts cannot exercise general jurisdiction over a corporation unless it is essentially 'at home' in the state where the court is based. The New York court in Vera rejected the Daimler argument in a prior decision and concluded that it could exercise personal jurisdiction over the two objecting banks.

The Spanish bank moved for reconsideration of that ruling in light of an intervening decision by the United States Courts of Appeal for the Second Circuit, the Appellate Court that oversees Federal Courts in New York, in the matter of Gucci v LI. In Gucci, the Second Circuit followed Daimler in holding that a Federal Court in New York did not have sufficient personal jurisdiction over the Bank of China to permit enforcement of an injuncture and subpoena that purported to reach an alleged trademark infringer's bank accounts in China. The Second Circuit also held that even if jurisdiction could be found, courts should be cautious if a Federal Court order would subject a party to obligations that conflicted with the laws of another nation, and in Gucci the Federal Court orders conflicted with bank secrecy laws of China.

The Vera Court concluded, however, that neither Gucci nor Daimler applied in that case, that it had jurisdiction over the Spanish bank, and that principles of international comity did not alter its conclusion. It therefore ordered the Spanish bank to produce "all information reasonably available to it which is responsive to the Information Supboenas, without limitation as to whether the accounts it provides information about are located in New York".

The Vera Court held that by registering with and obtaining a licence from the New York Department of Financial Services and by authorising the Department to accept service of process on its behalf, the Spanish bank had consented to general jurisdiction in New York in return for the right to operate a branch and conduct business in the forum. Foreign banking corporations doing business in New York are deemed to consent to jurisdiction in New York courts and are required to appoint the Department as their agent for service of process, but only for proceedings "arising out of a transaction with its New York Agency", which by the terms of the relevant statutory provisions is not a basis for general jurisdiction.

The court did not analyse the New York statute in reaching its conclusion, but it reasoned that foreign banks operating in New York should not be given advantages over domestic banks. The court expressed particular concern that allowing foreign banks to evade discovery concerning their foreign activities would authorise them to aid freely criminals and terrorists.

In rejecting the Spanish bank's reliance on the recent Gucci decision, the Vera Court refused to read Gucci 'so broadly' as to "eliminate the necessary regulatory oversight into foreign entities that operate within the boundaries of the United States". But the Vera Court only distinguished Gucci on the basis that the Second Circuit had left open the question whether the Bank of China had consented to personal jurisdiction in New York through its registration to conduct business there. The New York Banking Law itself does not allow such a reading, and Daimler would appear to require far more than registration to do business in a state to establish general jurisdiction over a bank having its headquarters and principal operations in Spain.

There is nonetheless reason to believe that the Vera Court did not intend to impose the unlimited burden upon a New York branch of producing all of a foreign bank's responsive records.

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The Court instead required the New York branch "to provide all information reasonably available to it". It would, of course, be the exception, rather than the rule, for the New York branch of a foreign financial institution to have direct electronic access to overseas accounts information. Yet provided such information is 'available', the Vera Court has made clear that geography should be no impediment to production.

This decision of the District Court has been taken on appeal to the Second Circuit. No decision in this matter is expected until later this year.

Adapted by Eugene Bester
(Source: Letter from America; DLA PIPER; Messrs Clarke, Jr, Hans and Walsh's article)

PRESCRIPTION: A PERFECT PRESENT FOR MIRACLE MILE?

Prescription has long been regulated in South Africa by means of the Prescription Act, No 68 of 1969 (Act). In terms of s10(1), a debt is extinguished by prescription after the effluxion of the prescription period laid down in the Act.

It is crucial for a creditor to be aware of the point at which prescription started running so as to avoid a situation where such a creditor loses the right to compel payment.

In the case of *Miracle Mile Investments 67 (Pty) Limited & Present Perfect Investments 116 (Pty) Ltd v The Standard Bank of South Africa Limited* (2013/22057) [2014] ZAGPJHC 423 (11 December 2014), the Gauteng Local Division of the High Court dealt with, among other things, the commencement of prescription in respect of a credit facility secured by suretyships.

N.C. Papachrysostomou (Nicolas) was granted a 'liberator facility' by the bank in terms of which an account was opened and a line of credit was extended to Nicolas in excess of R13 million. The bank also undertook to advance sums of money on Nicolas' behalf in respect of which the account would be debited. Nicolas agreed to pay the principal debt with interest over a period of 240 months by way of monthly instalments.

Miracle Mile and Present Perfect (Sureties) executed suretyship agreements in favour of the bank in terms of which they bound themselves as sureties and co-principal debtors *in solidum* with Nicolas for payment of any sum owing by Nicolas to the bank. They also registered 12 bonds as security pursuant to the suretyships.

Nicolas overdrew the account and was indebted to the bank in the amount of R7.4 million as at 21 October 2008. No further withdrawals or payments were made in respect of the account after this date.

Relying on s11 of the Act, the Sureties argued that the debt owed by Nicolas to the bank had been extinguished by prescription due to the bank's failure to take action for a period in excess of three years, and that the debt had therefore prescribed on 22 October 2011.

The bank raised several arguments to counter this. It attempted to distinguish between the liberator facility and a normal overdraft on the basis that repayments were not due on the date of any particular advance but rather in monthly instalments over the duration of the agreement.

The failure to pay a monthly instalment did not automatically accelerate the balance of the debt. In terms of the facility, the bank was entitled to convert it to one repayable by demand if Nicolas did not remedy his failure to pay within seven days of written notice from the bank. In such circumstances, the bank would also be entitled to terminate the facility and claim immediate payment of the outstanding balance. As no such notice was given, the bank contended that prescription could not have commenced.

The question for the court was whether the debt became 'due' within the meaning of s12(1) of the Act.

The court considered various articles written by academics but also had regard to a number of judgments which were critical of those academics.

The academics took the view that particular regard had to be had to the contract and the acceleration clause and that a normal acceleration clause does not itself make the balance of the debt payable, but rather gives the creditor an option to demand it, so prescription runs from this demand, not from the date of the debtor's failure to pay the instalment.

While admitting that such views may have merit, the case law considered found favour with the court. It was held that if the bank was entitled to accelerate payments and claim the full amount but failed to do so, this did not prevent prescription from running. Prescription would commence running from the date that the bank had the right to enforce payment of the full amount due, even if it chose not to give such notice.

The court also confirmed that the Sureties did not undertake a separate independent liability, but rather one which was accessory in nature. Therefore if the principal debt prescribed, so too did the Sureties' debts, regardless of the mortgage bonds registered as security for their liability.

Hayley Laing

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CONTACT US

For more information about our Dispute Resolution practice and services, please contact:

Eugene Bester
Director
T +27 (0)11 562 1173
E eugene.bester@dlacdh.com

Hayley Laing
Senior Associate
T + 27 (0)11 562 1232
E hayley.laing@dlacdh.com

Callum O'Connor
Senior Associate
T +27 (0)11 562 1044
E callum.oconnor@dlacdh.com

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BBBEE STATUS: LEVEL TWO CONTRIBUTOR

JOHANNESBURG
1 Protea Place Sandton Johannesburg 2196, Private Bag X40 Benmore 2010 South Africa
Dx 154 Randburg and Dx 42 Johannesburg
T +27 (0)11 562 1000 **F** +27 (0)11 562 1111 **E** jhb@dlacdh.com

CAPE TOWN
11 Buitengracht Street Cape Town 8001, PO Box 695 Cape Town 8000 South Africa
Dx 5 Cape Town
T +27 (0)21 481 6300 **F** +27 (0)21 481 6388 **E** ctn@dlacdh.com

cliffedekkerhofmeyr.com

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