

20 SEPTEMBER 2017

FINANCE AND BANKING ALERT

IN THIS ISSUE

THE NATURE OF CESSION IN SECURITY

The cession of incorporeal rights is a legal principle on which significant amounts of money are transacted in the South African market.

THE NATURE OF CESSION IN SECURITY

The court considered whether, as a matter of law, it was competent to cede a claim after the underlying obligation was extinguished by payment.

An often neglected principle is that cession is accessorial in nature. Its validity depends not only on compliance with common law, but also on the existence of a valid principal obligation.



The cession of incorporeal rights is a legal principle on which significant amounts of money are transacted in the South African market.

Cession is a bilateral juristic act whereby the cedent transfers its rights to the cessionary. The cession can be constructed as an out-and-out cession or as a cession in security. In a cession in security, the cedent transfers its right of action to a debt owed to it, known as the principal debt, to the cessionary as security for the debt owed by the cedent to the cessionary, known as the secured debt. A right of action is the legal standing to collect the principal debt. The ownership in the right however remains vested in the cedent despite the cession. The agreement to cede is created in an obligatory agreement such as a loan agreement or sale agreement. The duty to cede is discharged in a transfer agreement such as a cession and pledge agreement. The agreement to cede and the duty to cede may be contained in separate agreements or in one agreement.

An often neglected principle is that cession is accessorial in nature. Its validity depends not only on compliance with common law, but also on the existence of a valid principal obligation. In a cession in security, the cession secures the discharge of the secured debt. These principles originate in a 1931 judgment of the Appellate Division (as it then was) in *Kilburn v Kilburn* and may even have existed before then. It is the accessorial nature of cession which the Supreme Court of Appeal (SCA) recently confirmed in *Brayton Carlswald (Pty) Ltd and Another v Brews* (245/2016) [2017] ZASCA 68. The

court considered whether, as a matter of law, it was competent to cede a claim after the underlying obligation was extinguished by payment.

FirstRand Bank Ltd (Bank) obtained judgment against Brayton Carlswald (Pty) Ltd (Brayton) and Jonathan Paul Brews (JP Brews) (together, defendants) in an earlier case for the payment of a sum of money. It attached Brayton's properties to execute against the judgment. To the rescue came Gordan Donald Brews (GD Brews) who agreed to lend money to the defendants, the proceeds of which would settle their indebtedness to the Bank. As security for the loan, the defendants agreed (i) to procure a cession of shares in a company; (ii) to register a covering mortgage bond over the attached properties; and (iii) that the Bank's judgment would be ceded, all in favour of GD Brews. The Bank also agreed to cede, out-and-out, its judgment debt to GD Brews against payment by GD Brews of the judgment debt plus an additional amount. After further complications, GD Brews paid the Bank and sometime later the Bank ceded its judgment debt and additional rights, to GD Brews. Believing he had acquired the judgment debt by cession as security for his loan, GD Brews applied to the South Gauteng High Court for an order that he be substituted as execution creditor. A beneficiary of a trust that is the sole shareholder of Brayton, applied for leave to intervene in GD Brews's application on the basis that she and her daughters would suffer direct

THE NATURE OF CESSION IN SECURITY

CONTINUED

The SCA found that at the time that the Bank ceded the judgment debt, there was nothing to cede as GD Brews had, under his agreement with Brayton and JP Brews, paid the debt.



financial loss and lose their livelihood. The court dismissed GD Brews's application to be substituted as execution creditor. He appealed to the full court, which appeal was upheld. Brayton and the other appellant, Martina Brews thereafter, with leave, appealed against the full court's judgment.

The SCA held, as stated above, that a cession is a bilateral juristic act whereby the cedent transfers its rights to the cessionary. No formalities are required for the obligational agreement or the act of cession itself, although the parties may agree on formalities with which the cession must comply. The cession may be express or tacit or may be inferred from the parties conduct. Whilst the cession need not be reduced to writing, the parties may agree that it should be in writing, in which event it will only be valid if reduced to writing. The SCA examined the deed of cession to ascertain the parties' intentions. It held that it is a principle of contract interpretation that words must be ascribed their meaning in the context of the agreement, and must be applied to the subject matter to which they relate. The parties, held the SCA, intended that on signature of the deed of cession, the Bank would transfer the right to the judgment debt to GD Brews. The SCA criticised the court a quo's approach whereby it treated GD Brews as a surety and criticised its failure to distinguish between the agreement to cede and the cession itself.

However, the SCA found that at the time that the Bank ceded the judgment debt,

there was nothing to cede as GD Brews had, under his agreement with Brayton and JP Brews, paid the debt. In law, transfer by cession of a non-existent right is a nullity. The SCA also considered admissible correspondence between the Bank's attorneys and GD Brews's attorneys. It concluded that the parties had thereby clearly intended that the Bank would cede its claim after receiving payment in full. GD Brews tried to change his pleaded case contending that cession was a condition precedent to payment but the court dismissed this attempt as amongst other things, being inconsistent with the deed of cession.

The judgment holds important lessons for parties and their attorneys who rely on cession to create security. A claim that is going to be ceded, must be an extant claim. The debt which gives rise to the claim is settled on payment. So, if a claim is to be ceded, it is important to ensure that the debt is not settled before the claim is ceded.

We distinguish in law between non-existent rights and future rights. A future right is a right which does not exist on the cession date, but which may come into existence. Our law permits the cession in security of future rights.

Adnaan Kariem

OUR TEAM

For more information about our Finance and Banking practice and services, please contact:



Deon Wilken
National Practice Head
Director
T +27 (0)11 562 1096
E deon.wilken@cdhlegal.com



Stephen Boikanyo
Director
T +27 (0)11 562 1860
E stephen.boikanyo@cdhlegal.com



Stephen Gie
Director
T +27 (0)21 405 6051
E stephen.gie@cdhlegal.com



Adnaan Kariem
Director
T +27 (0)21 405 6102
E adnaan.kariem@cdhlegal.com



Bridget King
Director
T +27 (0)11 562 1027
E bridget.king@cdhlegal.com



Jacqueline King
Director
T +27 (0)11 562 1554
E jacqueline.king@cdhlegal.com



Izak Lessing
Director
T +27 (0)21 405 6013
E izak.lessing@cdhlegal.com



Mashudu Mphafudi
Director
T +27 (0)11 562 1093
E mashudu.mphafudi@cdhlegal.com



Preshan Singh Dhulam
Director
T +27 (0)11 562 1192
E preshan.singh@cdhlegal.com



Pierre Swart
Director
T +27 (0)11 562 1717
E pierre.swart@cdhlegal.com

Raaziq Ismail
Associate
T +27 (0)11 562 1687
E raaziq.ismail@cdhlegal.com

Kgotso Matjila
Associate
T +27 (0)11 562 1215
E kgotso.matjila@cdhlegal.com

Sidasha Naidoo
Associate
T +27 (0)11 562 1422
E sidasha.naidoo@cdhlegal.com

Vusiwe Ngcobo
Associate
T +27 (0)11 562 1329
E vusiwe.ngcobo@cdhlegal.com

Wandile Sishi
Associate
T +27 (0)11 562 1697
E wandile.sishi@cdhlegal.com

Mulalo Tshikovhele
Associate
T +27 (0)11 562 1193
E mulalo.tshikovhele@cdhlegal.com

BBBEE STATUS: LEVEL THREE CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 3 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

This information is published for general information purposes and is not intended to constitute legal advice. Specialist legal advice should always be sought in relation to any particular situation. Cliffe Dekker Hofmeyr will accept no responsibility for any actions taken or not taken on the basis of this publication.

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@cdhlegal.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@cdhlegal.com

©2017 1894/SEP

