

23 APRIL 2020

FINANCE & BANKING ALERT

IN THIS ISSUE

Cession in security: a cessionary's obligations

In South African law, cession is a bilateral juristic act whereby by agreement, a cedent transfers its rights, because of an underlying *causa*, to a cessionary. There are two types of cession, namely, an out and out cession and a pledge and cession *in securitatem debiti*.

Cession in security: a cessionary's obligations

An out and out cession is where the cedent divests and transfers its rights against its debtor to the cessionary so that the cessionary becomes the owner or holder of the rights.

In South African law, cession is a bilateral juristic act whereby by agreement, a cedent transfers its rights, because of an underlying *causa*, to a cessionary. There are two types of cession, namely, an out and out cession and a pledge and cession *in securitatem debiti*.

An out and out cession is where the cedent divests and transfers its rights against its debtor to the cessionary so that the cessionary becomes the owner or holder of the rights. The cessionary thereby becomes the new creditor of the debtor, who must henceforth render performance to the cessionary. In this type of cession, the rights leave the cedent's estate and vest in the cessionary's estate.

A pledge and cession *in securitatem debiti*, known as a cession in security or a security cession, is where the cedent pledges or encumbers its personal rights against its debtor and transfers such rights to the cessionary (ceded right(s)) to secure the fulfilment, by the cedent or a related party, of an obligation owed to the cessionary. A security cession is typically used to create a security interest in the cedent's personal rights to book debts, moneys in bank accounts, insurance policies or shares. It has been held in numerous judgments that a cession *in securitatem debiti* is analogous in law to a pledge of corporeal movable property.

The ceded rights arise from the contract between the cedent and its debtor and is known as the principal debt. The obligation is typically the repayment of a loan or the payment of a price for goods sold or services rendered and is known as the secured debt as security is provided for the debt. Whether the cedent cedes in security an aspect of a right, or the entire right, has been a controversial subject in South African law for more than a century. The issue is governed by competing theories that are beyond the scope of this article.

The Supreme Court of Appeal (SCA) held in *Grobler v Oosthuizen* [2009] 5 SA 500 (SCA) that the pledge theory governs the security cession of rights, and accordingly, the cedent retains the bare *dominium* or a reversionary interest in the rights and the cessionary acquires the exclusive right of action or the right to enforce the ceded rights, unless the parties elect the opposing theory to govern the cession, which is the fiduciary security cession theory. According to *Grobler* and other judgments, the cedent's reversionary interest is its interest in its debtor performing under the contract between the cedent and its debtor, and not its interest in the cessionary re-ceding the principal debt after the cedent satisfies the secured debt. The reversionary interest can also be pledged and ceded in security for an obligation, to either the cessionary that holds cession of the right of action, or to a different cessionary for a different obligation.

CDH is a Level 1 BEE contributor – our clients will benefit by virtue of the recognition of 135% of their legal services spend with our firm for purposes of their own BEE scorecards.

Cession in security: a cessionary's obligations...continued

A cessionary's obligations are determined by the law applicable to the type of security instrument that creates the security.

An often-neglected subject is the cessionary's obligations, which we analyse in this article. The cessionary's obligations are determined by the law applicable to the type of security instrument that creates the security and the terms of the obligational agreement entered into between it and the cedent. The obligational agreement is the agreement that creates the duty to cede. The execution of the duty to cede is typically contained in a cession or transfer agreement. It is often the case that the duty to cede (contained in the obligational agreement) and the execution or fulfilment of the duty to cede (contained in the cession or transfer agreement) is contained in one document and is subject to the same conditions precedent, but the duty to cede and its execution remain separate juristic acts.

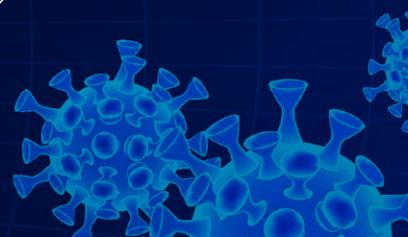
As mentioned, a cessionary's obligations are determined by the law applicable to the type of security instrument that creates the security. Authority for this is to be found in *Bisnath v Absa Bank Limited; Absa Bank Limited v Bisnath and Another* [2008] 3 All SA 219 (SCA), where the SCA adjudicated a number of appeals regarding, amongst

others, whether the bank as the mortgagee allegedly in possession of property attached under a court order, should have collected the rentals due and owing, which in turn, would have extinguished the debt for which a default judgment had been granted. If this was correct, then a court order that declared the property executable, was wrongly ordered, contended the appellants.

The SCA adopted the legal position taken in judgments by the then Transvaal courts in 1907 and 1922 respectively that, under Roman Dutch law, a pledgee must take care of the property pledged and must account for the fruits or profits arising from the property pledged. However, the SCA held that it did not follow that a mortgagee had the same obligations in respect of fruits or profits arising from mortgaged immovable property. The reason that the SCA drew this distinction lies in the fact that in the case of a pledge of movable property, the pledgee was usually in possession of the movable property as possession is a requirement to constitute a pledge, whereas in the case of a mortgage of immovable property, the

CDH'S COVID-19 RESOURCE HUB

Click here for more information 



Cession in security: a cessionary's obligations...continued

A cessionary's obligations are further determined by the terms of the obligatory agreement.

mortgagee was usually not in possession of the immovable property as it was in the mortgagor's possession. If, in a particular case, it was alleged that the mortgagee was in possession of the mortgaged immovable property, as was the allegation in *Bisnath*, then the onus of proving possession rests on the party who asserts such possession.

In *Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Company Ltd and others* [2013] 3 All SA 337 (WCC), the Western Cape High Court (WCC) held that a cessionary (of a right ceded in security), like a pledgee (of corporeal movable property pledged in security) must act as a *bonus paterfamilias* (an ordinary prudent person; one who takes reasonable precautions to protect amongst others, his property) in relation to the ceded right, has a duty to exercise due diligence in respect of the ceded right and must protect the cedent's interests in the right. The WCC held that if the cessionary failed in these obligations, the cedent may, depending on the circumstances, have a damages claim against the cessionary. The WCC further held that whether the cessionary may collect the principal debt from the debtor where the cedent was not in default of the secured debt because it was servicing the secured debt, was a factual and not a legal issue, to be answered with reference to the terms of the obligatory agreement.

A cessionary's obligations are further determined by the terms of the obligatory agreement. It is therefore necessary for the parties to the cession to clearly and unambiguously set out the substance and form of the cessionary's

obligations in relation to the ceded rights in the obligatory agreement, including its obligations in circumstances where the cedent is not in default of the secured debt.

If the cedent defaults on the secured debt by for example, not repaying the loan, the cessionary is entitled to, at that time but not before, realise its security by exercising its *locus standi* to collect the principal debt and use the proceeds to settle the secured debt. Whether the cessionary may do so prior to the cedent defaulting on the secured debt is, as mentioned above, a factual issue to be determined by the terms of the obligatory agreement.

It is evident that South African law ascribes obligations to a cessionary of rights held in security to, amongst others, preserve, take care of, and protect the cedent's interests in the ceded rights. In loan transactions where lenders take security in the form of cessions in security of personal rights, lenders as cessionaries acquire these obligations in respect of the ceded rights by operation of the common law. It is therefore important for lenders who are cessionaries of rights in security, to be cognisant of these obligations, to contract out of these obligations if they do not want to be bound by it or abide by these obligations if they choose to be bound by it. It is conceivable that if a cessionary failed to honour its common law obligations or its contractual obligations in respect of the ceded claim, the cedent could sue the cessionary for any damages that it may suffer in consequence of the cessionary's failure.

Adnaan Kariem

OUR TEAM

For more information about our Finance & 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



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

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

Kuda Chimedza
Associate
T +27 (0)11 562 1737
E kuda.chimedza@cdhlegal.com

Stephanie Goncalves
Associate
T +27 (0)11 562 1448
E stephanie.goncalves@cdhlegal.com

Jordan Maze
Associate
T +27 (0)21 481 6361
E jordan.maze@cdhlegal.com

Andile Sangweni
Associate
T +27 (0)11 562 1046
E andile.sangweni@cdhlegal.com

BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 1 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

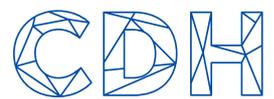
CAPE TOWN

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

STELLENBOSCH

14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.
T +27 (0)21 481 6400 E cdh Stellenbosch@cdhlegal.com

©2020 8880/APR



CLIFFE DEKKER HOFMEYR