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FINANCE & BANKING ALERT

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Cession in security: The real meaning of reversionary interest

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Cession in security: The real meaning of reversionary interest

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In this article, we discuss the real meaning of *reversionary interest* and expose misconceptions as to its meaning. The premise for this article is the pledge theory of cession in security. The terminology used in this article has the meaning ascribed to it in previous articles.

It is trite law that certain types of personal rights to a principal debt (the debt owed by a debtor to a cedent) can be used, by its pledge and cession in security, to secure the repayment of a loan or some other obligation. At common law and technically, it is not the principal debt that is ceded in security though, but the personal right to the principal debt. In terms of the pledge theory of cession in security, a cedent retains the *dominium* or *reversionary interest* in the principal debt while ceding (transferring) the right of action (the right to collect or enforce) to that principal debt, to the cessionary, as security for the secured debt (the debt owed by the cedent to the cessionary). It is because the cedent retains the said *dominium* or *reversionary interest* during the subsistence of a cession in security, that the principal debt is accounted for in the cedent's insolvent estate. The cedent is by such cession, divested of the legal standing to collect or enforce the principal debt, which vests in the cessionary, for so long as the secured debt remains unpaid. If the cedent defaults on the

secured debt, the cessionary may realise its security rights in the principal debt and use its proceeds to settle the secured debt, which in our instance is a loan.

In *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) the Supreme Court of Appeal held that these are the principles applicable to cession in security. Furthermore, if the cedent defaults on the secured debt, and the cessionary realises the principal debt, the proceeds of which exceed the value of the secured debt, the cessionary must refund the excess to the cedent. On the other hand, the cedent remains liable to the cessionary for any shortfall between the principal debt and the secured debt that may occur if the cessionary realises its security interests.

It is in this context that the term *reversionary interest* is often incorrectly and loosely described as the cedent's right to, or right to claim back, the right of action to the principal debt ceded to the cessionary as security, once the cedent settles the secured debt. The understanding that *reversionary interest* means the cedent's right to, or right to claim back, the right of action to the principal debt, can possibly be ascribed to certain judgments, some of which date back many years.

In *Grobler*, the court analysed the nature of *reversionary interests* and held that the judgments that had described it as the cedent's right to, or right to claim back, the right of action to the principal debt from the cessionary once the cedent settles the secured debt, were wrongly decided in law. The court held at page 510 in paragraph 22 –

"[22] As to the real meaning of the cedent's 'reversionary interest', I can do no better than to refer to the following explanation by Nienaber JA in

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...continued

It is evident from the quotation that the cedent's reversionary interest is not its interest in reclaiming the rights to the ceded principal debt, but rather it is the cedent's interest in its debtor rendering performance of the principal debt in terms of the contract between the cedent and its debtor.

Development Bank of Southern Africa Ltd v Van Rensburg supra para 50 with which I respectfully agree:

"This reversionary interest, properly understood, refers to the cedent's interest in the debtor's performance (ie satisfaction of the principal debt by the debtor) rather than to his interest in the cessionary's performance (ie recession of the principal debt on satisfaction of the secured debt which is [sc would be] a right ex contractu against the cessionary)." (See also eg Moola v Estate Moola supra at 464B D; PE Streicher 'Toekomstige Regte, Boekskulde en Insolvensie' in Sessie in Securitate Debiti Quo Vadis? (Susan Scott ed) 136 at 145 6; Van der Merwe et al Contract op cit 499; LAWSA op cit paras 53 (fn 14), 55 and 56 (fn 17).)"

It is evident from the quotation that the cedent's reversionary interest is not its interest in reclaiming the rights to the ceded principal debt, but rather it is the cedent's interest in its debtor rendering performance of the principal debt in terms of the contract between the cedent and its debtor. The reversionary interest therefore has nothing to do with the cessionary's security interest in the principal debt but

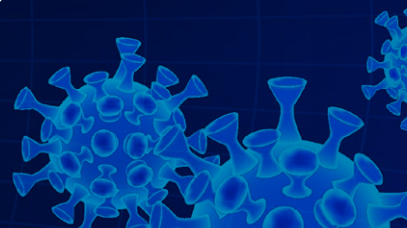
has instead to do with the debtor rendering performance of the principal debt. It can also be conveniently described as the cedent's residual interest in the principal debt. The reversionary interest can itself be ceded in security, as indicated above. Practically, if the principal debt entitles the cedent to payment of a sum of money due by its debtor, such as in the case of monies in bank accounts (that are ceded in security), the cedent's reversionary interest is its interest in payment of any balance due to it after the cessionary's secured claims are settled.

A lawyer who advises a client on a cession in security must carefully consider, and correctly identify, applying the principles set out in this article, the cedent's reversionary interest in the subject matter of the cession, which must then be drafted into the cession in security agreement. The reversionary interest is the cedent's interest in its debtor rendering performance under the contract between the cedent and its debtor. A description of the reversionary interest as the cedent's interest in the recession of the right of action to the principal debt after the secured debt is settled, is incorrect in law.

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