BUSINESS RESCUE & INSOLVENCY

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BIG WIN FOR BANKS AGAINST SURETIES IN CONTEXT OF BUSINESS RESCUE

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Ever since the new business rescue regime, contained in Chapter 6 of the Companies Act, No 71 of 2008 came into force in May 2011 there has been much anticipation as to how courts would treat sureties who had stood and provided security for the debts of a company (principal debtor) that subsequently went into business rescue and had a business rescue plan adopted: would such suretyships remain unaffected and enforceable? The question was tested in the courts quite early on in the business rescue regime, with varying and conflicting views expressed by judges, but on 1 December 2014 the Supreme Court of Appeal (SCA) delivered what should be the final word on the matter (unless a constitutional challenge is launched). The judgment, *New Port Finance Company (Pty) Ltd and others v Mostert and others*, will have far-reaching consequences in the banking and finance arena and should provide a great deal of comfort to lenders.

In *New Port*, a company and a natural person (a director of one of the borrowers) signed as sureties for the debts of two borrower companies. Those borrower companies became financially distressed, were placed in liquidation but then taken out of liquidation and placed in business rescue by the court under s130(1) of the Companies Act. Business rescue plans were ultimately adopted in respect of the borrower companies which plans provided for the restructuring of the borrower companies' debts.

An argument was raised on behalf of the sureties that because the business rescue plan allegedly had the effect of altering or compromising the underlying principal debt, the lenders could not pursue the sureties or enforce their claims against them until the business rescue process had run its course.

In this regard reliance was placed on the recent Western Cape High Court case of *Tuning Fork (Pty) Ltd t/a Balanced Audio v Greeff and another* where it was held that the adoption of a business rescue plan has, as a point of departure and absent a very specific clause in the deed of suretyship or business rescue plan preserving the lender's right to pursue the surety for the full original amount of the debt, the potential consequence that the claim against the surety may be similarly compromised or reduced.

The SCA in *New Port* however adopted a strikingly more creditor-friendly interpretation of the business rescue provisions. In the first place, the deeds of suretyship in this case contained the very standard clauses one finds which deal with the eventuality of the principal debtor compromising or otherwise re-arranging its debts generally with its creditors.

The SCA held that these clauses undoubtedly bring business rescue within their ambit and cater for such eventuality, such that the adoption of a business rescue plan would not prejudice the lender's (full) claims against the sureties on a joint and several basis. This in itself is a big decision in favour of creditors, and the SCA's stance on this aspect should give comfort to the many creditors in South Africa who have that standard wording, or similar wording along those lines, as terms in their deeds of suretyship.

However, the SCA went even further and suggested (but without deciding) that even in the absence of such wording, the creditor's rights against sureties are not affected by the adoption of a business rescue plan. The finding in *New Port* confirms that creditors' claims against sureties are not affected by a business rescue plan entered into with a principal debtor unless specific wording to that effect is contained in the plan itself.

The *New Port* judgment represents one of the most important and far-reaching decisions to date under the new business rescue regime, a regime which is being tested and interpreted on a regular basis by the High Court. It is still recommended that deeds of suretyship contain express clauses fully preserving the creditor's rights in instances where the borrower company generally compromises its debts (such as business rescue), as the *New Port* judgment at the very least solidifies that such a clause will preserve the creditor's rights to pursue the surety for the full debt.

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