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DISPUTE RESOLUTION **ALERT**

IN THIS **ISSUE**

The power of a court when a settlement agreement is not preceded by litigation

"We have frequently pointed out that the court is not a registry of obligations. Where persons enter into an agreement, the obligee's remedy is to sue on it, obtain judgment and execute." Those were the words of the full bench more than 66 years ago in *Mansell v Mansell* 1953 (3) SA 716 (N) at 721.

Sureties and business rescue - you can run but you can't hide

It is trite law that the liability of a surety is unaffected by the business rescue of the principal debtor, unless the business rescue plan makes specific provision for the situation of sureties. However, in practice, sureties continue to try to avoid liability under their suretyship agreements.

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The power of a court when a settlement agreement is not preceded by litigation

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"We have frequently pointed out that the court is not a registry of obligations. Where persons enter into an agreement, the obligee's remedy is to sue on it, obtain judgment and execute." Those were the words of the full bench more than 66 years ago in *Mansell v Mansell* 1953 (3) SA 716 (N) at 721. This aligns to the generally accepted principle that courts of law exist for the settlement of concrete controversies and actual infringements of rights, not to pronounce upon abstract questions, or to advise upon differing contentions, however important.

An issue that often arises is whether a settlement agreement may be made an order of court when the parties reach agreement without commencing litigation. In *Avnet South Africa (Pty) Limited v Lesira Manufacturing (Pty) Limited and Another* (18/38649) [2019] ZAGPJHC 72 (4 March 2019), Budlender AJ recently faced this question. The facts were crisp and straightforward: In terms of an agreement between the parties, the applicant supplied the first respondent with goods to the value of R23,59 million. The parties signed a settlement agreement in terms of which, amongst others, the debt would be paid in monthly instalments and the settlement agreement would be made an order of court and the respondent would not oppose it.

The court considered the divergent High Court judgments on the issue to conclude that where litigation has not yet commenced, a settlement agreement may not be made an order of court. This issue was first considered by Van der Byl AJ in *Growthpoint Properties Ltd v Makhonyana Technologies (Pty) Ltd and others NGHC Case No.* 67029/2011 (12 February 2013). In this judgment the court reasoned that there was at one stage a dispute between the parties, albeit before any litigation was commenced between them, relating to the amount payable in respect of arrears rental. That dispute was settled via a settlement agreement which the parties agreed could be made an order of court. Therefore, as soon as a party may institute legal action against another party, the former may apply to court to have a settlement agreement made an order of court without incurring the costs associated with litigation. The court further reasoned that having jurisdiction to grant such an order only after the parties have instituted legal proceedings was akin to a duplication of legal proceedings. The court made the settlement agreement an order of court absent any preceding legal proceedings between the parties.

The issue was further dealt with by Van der Linde J in *Lodestone Investments (Pty) Ltd v Muhammad Ebrahim t/a Ndimoyo Transport GLD Case No. 5716/2016 (29 April 2016)* and *National Youth Development Agency v Dual Point Consulting (Pty) Ltd and Another* (06982/2016) [2016] ZAGPJHC 114 (19 May 2016). In both matters, the court declined to decide on the issue. In *Dual Point Consulting*, the court, however, set out important considerations, namely:

- "If the legislature was prepared to lend the enforcement arm of the law no matter what the underlying process; no matter how the settlement came about; no matter whether there was a fair underlying process; one would

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The power of a court when a settlement agreement is not preceded by litigation...*continued*

The court relied on a *dictum in Eke v Parsons 2016* (3) SA 37 (CC) that "parties contracting outside the context of litigation may not approach a court and ask that their agreement be made an order of court".

have expected explicit legislation to that effect." There is no such provision in legislation;

- The primary function of the courts is to determine disputes between parties; and
- The concern about the notion of a court assuming the role of a debt collector without its processes previously being engaged; a settlement agreement sought to be made an order of court would principally have the sword of Damocles hang over the debtor's head.

As stated above, the court in *Avnet* declined to make the settlement agreement an order of court on the basis that no litigation had commenced between the parties and therefore it did not have jurisdiction. The court relied on a *dictum* in *Eke v Parsons* 2016 (3) SA 37 (CC) that "parties contracting outside the context of litigation may not approach a court and ask that their agreement be made an order of court". First, it was held that the primary function of the courts was defined as adjudicating disputes between parties. From this the court could not adjudicate or grant an order where a dispute was not before it. Drawing from *PL v YL* 2013 (6) SA 28 (ECG) the court held that it may only make orders that are "competent and proper" with the antithesis that a court may not be mechanical in granting orders. For an order to be proper and competent, a relationship between the order and a dispute between the parties must exist.

Second, if courts were deemed to have the jurisdiction to make settlement agreements court orders before the institution of any related legal proceedings between the parties, the role of the courts would expand to functions like debt collection and registration of a superfluous and undefined number of agreements. The scope of the court's jurisdiction would expand beyond any issues the parties may bring before the court. Another consequence is the severity attached to non-compliance with a court order would similarly be attached to any settlement agreement (or any agreement) made a court order before the parties to the agreement instituted any related legal proceedings. This implies that any breach of the agreement would trigger contempt proceedings, with consequences such as imprisonment and breach of the Constitution over and above the common law remedies already available for breach of contract before the parties instituted any dispute resolution proceedings.

The court was therefore of the view that it did not seem permissible or appropriate for parties to be free to clothe their agreement with these consequences, if the agreement is not resolving a matter already before the court. Even though the above legal position has not been directly confirmed by the Supreme Court or the Constitutional Court and seems correct in principle, it remains to been seen whether it will lead to unnecessary duplication of legal proceedings and have an impact on the rather crowded court rolls in the various divisions.

Vincent Manko, Johanna Lubuma and Camille Kafula

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Sureties and business rescue - you can run but you can't hide

In the case of New Port Finance Co (Pty) Ltd and Another v Nedbank Ltd 2016 (5) SA 503 (SCA) the court held that, provided the deed of suretyship contains a clause that affords the creditor a right to pursue the surety, even if the principal debt has been compromised, this will override a compromise in the BR plan.

It is trite law that the liability of a surety is unaffected by the business rescue of the principal debtor, unless the business rescue plan makes specific provision for the situation of sureties. However, in practice, sureties continue to try to avoid liability under their suretyship agreements.

Section 154 of the Companies Act, No 71 of 2008 (Act) provides that a business rescue plan (BR plan) may provide that a creditor, who has acceded to the discharge of the whole or part of a debt owing to that creditor, will lose the right to enforce the debt or part of it. Furthermore, if a BR plan has been approved and implemented, a creditor is not entitled to enforce any debt owed by the company immediately before the beginning of the business rescue process, except to the extent provided for in the BR plan. Thus, the legislation contemplates a compromise of claims of creditors against a debtor in business rescue.

Chapter 6 of the Act dealing with business rescue does not address the position of a surety for a company in business rescue.

Legal position prior to the adoption of a BR plan

In *Investec Bank v Andre Bruyns* 2012 (5) SA 430 (WCC) it was held that the moratorium on legal proceedings in respect of a company in business rescue did not extend to the sureties of the company.

In *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd & Others* 2013 (6) SA 471 (GNP), the court held that the liability of sureties for the company's debts is not affected and they remain liable.

Legal position after the adoption of a business rescue plan

In *Tuning Fork v Greeff* 2014 (4) SA 521 (WCC), a creditor who had been paid out 28 cents in the rand by a company in full and final settlement of its indebtedness following a business rescue compromise, sought to recover the remainder of the company's debt from the sureties. The court stated that if a BR plan provides for the discharge of the principal debt by way of a release of the principal debtor, and the claim against the surety is not preserved in the BR plan or in the deed of suretyship, the surety is discharged.

In *Absa Bank Limited v Du Toit and Others* 7311/13 the court decided that a provision in the BR plan for "full and final settlement of its indebtedness" results in the principal debt being extinguished.

In *DH Brothers Industries (Pty) Ltd v Gribnitz NO & Others* 2014 (1) SA 103 (KZP) the court held that if the BR plan provided for a discharge of the main debt (to which the creditor agreed or "acceded"), it had the effect as stipulated in the common law that the liability of a surety for that debt would also cease to exist.

In the case of *New Port Finance Co (Pty) Ltd and Another v Nedbank Ltd 2016 (5) SA 503 (SCA)* the court held that, provided the deed of suretyship contains a clause that affords the creditor a right to pursue the surety, even if the principal debt has been compromised, this will override a compromise in the BR plan.

The *Hitachi* case

In the recent case of *Hitachi Construction Machinery Southern Africa Co (Pty) Ltd v Botes and Another* (205/2018) [2019] ZANCHC 7 (15 March 2019), the applicant

Sureties and business rescue - you can run but you can't hide...*continued*

The court held that, while the debt may not be enforceable against Blue Chip as the principal debtor, it did not detract from the liability of the sureties to pay.

creditor, on the strength of a deed of suretyship, claimed the balance of the pre-business rescue debt from the respondent sureties, as well as the balance in respect of post-commencement financing together with interest.

The sureties opposed the application on two main grounds. Firstly, they contended that once the BR plan of the company in rescue (Blue Chip) was adopted, the applicant lost the right to claim any further amounts from the sureties. Secondly, they placed the quantification of the indebtedness in dispute.

The right of the applicant to claim from the sureties

It was not in dispute that the BR plan released Blue Chip from its debt to the applicant. However, the court had to consider whether this meant that the debt had been extinguished.

The court referred to the *New Port* case, where it stated that s154 of Act "deals only with the ability to sue the principal debtor and not with the existence of the debt itself". The liability of a surety is unaffected by the business rescue, unless the BR plan itself makes specific provision for the situation of sureties. However, the BR plan of Blue Chip made no provision for the position of sureties.

The court held that, while the debt may not be enforceable against Blue Chip as the principal debtor, it did not detract from the liability of the sureties to pay. The sureties' argument that, since no amount remained owing by Blue Chip in terms of the BR plan, the sureties were not liable in terms of the deed of suretyship, "[w]ould render the terms of the deed of suretyship nonsensical and militates against the very reason for a creditor obtaining security against the indebtedness of a debtor, ie to mitigate the risk of the debtor being unable to fulfil its obligations due to *inter alia* business rescue".

The court concluded that the BR plan did not release the sureties from their indebtedness to the applicant.

The quantification of claims

The applicant contended that the acknowledgment and admission of the debts by the Business Rescue Practitioner (BRP) constituted an admission and acknowledgement of the indebtedness by Blue Chip as the principal debtor to the applicant, which was binding on the sureties. In this regard, reference was made to the deed of suretyship which provided that "all admissions and acknowledgments of indebtedness by the Debtor shall be binding upon us...".

The sureties attacked the quantification of the claims on the basis that the BRPs merely perform a statutory function in terms of s145(5) of the Act, by including the applicant's claim in the schedule of creditors, and did not act in any other capacity or on behalf of the principal debtor and therefore an admission by the BRPs of Blue Chip's indebtedness was not an admission by Blue Chip.

The court stated that Chapter 6 of the Act abounds with functions of the BRPs in business rescue proceedings. Section 140(1)(a) of the Act provides that, during a company's business rescue proceedings, the BRP has full management control of the company in substitution for its board and pre-existing management.

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Sureties and business rescue - you can run but you can't hide...*continued*

The admission and acknowledgment of indebtedness by the BRPs constituted an admission and acknowledgment by the principal debtor which, in terms of the deed of suretyship, was binding on the sureties.

The court held that, the BRPs therefore step into the shoes of the company in business rescue. They are "[n]ot merely a postbox for the receipt of claims as seems to be suggested by the respondents". In fact, the BR plan of Blue Chip stated that the BRPs assumed management control of the company in conjunction with the board of directors and pre-existing executive management. The claims were reviewed in detail. The sureties were both directors of Blue Chip as well as members of the executive management and it would be surprising if they did not participate and assist in the verification of the claims submitted by the creditors and which they now dispute.

It was concluded that the admission and acknowledgment of indebtedness by the BRPs constituted an admission and acknowledgment by the principal debtor which, in terms of the deed of suretyship, was binding on the sureties.

Conclusion

The *Hitachi* case reaffirms the legal principles already set out in previous case law on the liability of sureties in business rescue.

Creditors will, however, have no recourse against sureties for the recovery of the balance of the principal debt of a company in business rescue where a BR plan is adopted that provides for a compromise of claims and where the deed of suretyship is silent on the enforceability of the surety in the event of the company going into business rescue.

Accordingly, it is crucial from a creditor's perspective that the deed of suretyship provides adequately for the rights of the creditor. This can be done by stating expressly that, should the company go into business rescue, this does not detract from the right of the creditor to recover from the surety the full amount for which it is bound under the suretyship. Another way for a creditor to adequately protect its rights is by obtaining a guarantee instead of a suretyship. A guarantee creates a principal obligation, not an ancillary obligation and, therefore, would not automatically be extinguished by a compromise of the principal debt. In addition, it is prudent that the creditor's rights in respect of sureties are properly canvassed and specifically preserved in the BR plan.

Kylene Weyers and Tobie Jordaan

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