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SOUTH AFRICA

The forms of cession in
security in South African law

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The forms of cession in security in South African law

In South African law, the pledge and cession *in securitatem debiti* of rights can be based on either the pledge theory or the *pactum fiduciae*/outright cession theory.

In the recent judgment in *Batteson N.O. v Joubert* N.O. 2025 SACLR 327 (A) (Batteson), the Supreme Court of Appeal (SCA) confirmed that these two forms of security cession are available to parties. The SCA thereby confirmed the earlier watershed SCA judgment in *Grobler v Oosthuizen* [2009] (5) SA 500 (SCA) (Grobler) which likewise held that it was open to the parties to select which of the two theories to apply and that, absent a choice or clear intention of the parties, the default legal position is that the pledge theory applies to the cession.

Personal rights, such as a right to a debt, are typically pledged and ceded in security, to secure the repayment of another debt.

Batteson

In *Batteson*, the trustees of the Batfarm Trust (Trust) as applicants, sought special leave to appeal against the order of the full court of the Eastern Cape Division of the High Court, Makhanda. At the centre of the application was whether the cession of a Sanlam Life Insurance Policy, held by the late Jan Hendrik Abraham Bezuidenhout (deceased), was a cession *in securitatem debiti* or an outright cession that permanently divested the cedent thereof. The trial court had held in favour of the respondents,

the joint liquidators of the Geheeltevrede Boerdery CC (CC), that the cession was not a cession *in securitatem debiti*. On appeal, the full court held that the cession was a cession *in securitatem debiti*.

A truncated version of the facts is provided. Pursuant to the sale of land by the CC to the Trust and a lease back, the CC signed a lease agreement with the Trust. The deceased also signed the lease agreement in his personal capacity. Some years later, the CC and the Trust signed a second lease agreement and the deceased again signed this lease agreement in his personal capacity. Both lease agreements contained identical clauses that required the deceased to cede:

"...as an absolute Cession, an existing Life Assurance Policy of R4 000 000 (FOUR MILLION RAND) on his life to and in favour of the LESSOR, so as to safeguard the LESSOR against payment of its rental and outstanding balance due by the LESSOR under its Mortgage Bond with a Financial Institution, in the event of the death of the Sole Member of the LESSEE, JAN HENDRIK ABRAHAM BEZUIDENHOUT." The CC was also granted an option to repurchase the property, in which event *"the LESSOR shall cede the aforesaid Assurance Policy back to the LESSEE against payment of all the LIFE Premiums paid by the LESSOR, whilst ceded to it, together with interest thereon at the prime bank overdraft rate."*



The deceased died on 1 September 2019 during the currency of the second lease. His wife and his accountant were appointed as joint executors of his deceased estate. The CC was provisionally, then finally, wound up during 2018. What followed were a series of claims and set-offs that occurred between the Trust and the CC in respect of amounts owed based on the history of the matter and the clause quoted above.

The SCA examined the reasoning of the full court's finding that the cession was *in securitatem debiti*, the Trust's contentions regarding its (alleged) ownership of the proceeds of the policy arising from the absolute cession (see quote above), the pleadings, the burden of proof, the evidence and it discussed the legal requirements for granting special leave. These issues are beyond the scope of this article.

Interpreting the cession

The SCA stated that the primary issue in determining the Trust's prospects of success in its application for special leave was the proper interpretation of the words that recorded the cession. It affirmed the legal position that the interpretation of contracts is a unitary exercise in which the words or text, context of the words or text in light of the document as a whole and purpose, are considered together. A sensible meaning is preferred instead of one that leads to un-business like results or undermines the purpose of the document.

In order to interpret the words of cession in the leases, the SCA considered the nature and effect of cession in general terms. It held that incorporeal rights are transferred by the cedent ceding it to the cessionary, which divests the cedent of rights in the subject matter of what is ceded. It involves an agreement to cede known as the *pactum cedendo* which, in terms of our case law, creates the duty or obligation to cede and is the *causa* of the cession. The agreement to cede is followed by the deed of cession. Our case law has established that the deed of cession is effectively the transfer agreement that gives effect to the duty or obligation to cede and is known as the *pactum cessionis*. The nature of the cession and the underlying *causa* determines the extent to which the cedent is divested of his or her rights, held the court. Conversely, whether a cession is *in securitatem debiti* or not depends on the extent to which the cedent is divested of his or her rights, if the words properly interpreted supports such interpretation.

In the SCA's view, the label given to cession "*is not necessarily decisive of the nature and effect thereof*". In an out-and-out cession, the cedent is permanently divested of his or her rights and benefits in the subject matter and the cessionary becomes the unqualified owner thereof. In a cession *in securitatem debiti* on the other hand, there is no intention to permanently divest the cedent of his or her ownership in the subject matter. Such a cession serves the limited purpose of securing a debt.

The court noted that a cession *in securitatem debiti*:

"...has been described as 'in effect an outright or out-and-out cession on which an undertaking, or pactum fiduciae (fiduciary agreement), is superimposed, that the cessionary will re-cede the principal debt to the cedent on satisfaction of the secured debt. It has also been remarked that, the truth probably is that the cedent by way of security retains his reversionary right, that is to say his right to enforce the ceded right of action after the secured debt has been discharged."

Theories of cession *in securitatem debiti*

The SCA went on to discuss the two different theories or forms of cession in security. It held that in terms of the pledge theory, the cedent retains ownership of the right in the subject matter and a reversionary interest. The ceded rights in the subject matter automatically revert to the cedent on settlement of the secured debt without the need for a re-cession or to comply with any formality to restore the ceded rights to the cedent (This is also the position in *Grobler v Oosthuizen* [2009] (5) SA 500 (SCA)). In terms of the outright cession theory, a *pactum fiduciae* is super-imposed on the cession requiring the cessionary, on settlement of the secured debt, to re-cede the ceded rights to the cedent. The court in *Batteson* made it clear, in the same way that the court did in *Grobler*, that a cession *in securitatem debiti* could take either form. The court held that in either form, the intention was not a permanent divestiture of rights in the subject matter altogether. A risk in the

outright cession theory is if the cessionary goes insolvent, the ceded rights would form part of the cessionary's insolvent estate, and the cedent would only have a concurrent claim against the cessionary's estate.

The SCA held that form should not override substance, and if the object was to secure a debt, then it is a cession *in securitatem debiti* regardless of what the parties call it. Even a statement (in a cession document) that ownership (in the rights) was transferred to the cessionary is not conclusive thereof if it is subject to an implied *pactum fiduciae* that the subject matter or what is left after the settlement of the secured debt would revert to the cedent.

Applying these principles, the SCA considered the issue in dispute, namely, whether the cession by the deceased was *in securitatem debiti* or an absolute cession transferring ownership to the Trust. It appears that the dispute arose in part because the clause in the first lease agreement (and for that matter the identical clause in the second lease agreement) that obliged the deceased to take out and cede a life assurance policy, described it as an "absolute cession". The court noted that the R4 million life policy was ceded to safeguard two liabilities. First, it safeguarded payment of the rental that would be due to the Trust. Secondly, it safeguarded a mortgage liability to Standard Bank. Specifying the value of the life policy helped to achieve its purpose, namely to safeguard against the aforesaid liabilities.

Other factors

The court also considered the issue from different angles.

It included the destructive effect that interpreting the cession as an out-and-out cession would have on the safeguarding purpose of the cession. It would be unbusinesslike for the deceased to provide an absolute out-and-out cession permanently divesting him and his estate of the policy's proceeds when the first lease was concluded and before transfer of the property to the Trust.

Interpreting the word "absolute" in the relevant clause of the policy in isolation fails to address the substance of the cession agreement. Even though the word "absolute" may suggest that an outright cession instead of a cession *in securitatem debiti* was intended, the cession was intended to safeguard the aforesaid liabilities. As the wording of the cession was intended to safeguard these liabilities, the wording favoured the cession being subject to a *pactum fiduciae* despite the use of the word "absolute" such that the balance of the insurance proceeds would, after settling the liabilities, revert to the deceased's estate.

The court commented on clause 22.2 in terms of which, if the lessee (the CC) exercised its option to repurchase the property, the lessor (the Trust) would be required to cede the policy back to the lessee.

The court held that although clause 22.2 did not assist with interpreting the cession, the recession of the policy (if the lessee exercised its repurchase option) suggested an initial outright cession, which was in line with a *pactum fiduciae* once the cession served its purpose.

An email from the deceased to his accountant also confirmed that the deceased intended the cession to act as security, and that he would receive the remainder of the insurance proceeds after the Trust's liabilities were paid.

The SCA was not convinced that the full court erred in its judgment. The court held that there are no reasonable prospects of success in any appeal and that the Trust had not established any special circumstances requiring that special leave to appeal be granted. The court accordingly dismissed the application for special leave to appeal with costs.

Construction of the cession

Part of the difficulty in this case is the reliance that the Trust placed on the wording that the cession was an "*absolute cession*" as quoted above. On the face of it, the clause may appear contradictory in that it seems to combine an absolute cession and a security cession, where the absolute cession safeguards the Trust or put differently, provides security for the rental due to the Trust and the balance of monies due by the Trust to its lender. The construction of the clause therefore, it is submitted, understandably led to conflicting interpretations.

An absolute cession would typically be an out-and-out cession where there is complete divestiture of the right so that it leaves the cedent's estate and is transferred to (ceded) and is counted as part of, the cessionary's estate. The Trust erroneously relied heavily on the "*absolute cession*" of the policy to mean that the cession was an out-and-out cession that vested ownership thereof.

Lessons

If the cession clause had been drafted clearly as a cession *in securitatem debiti* without the use of the absolute cession concept, the dispute may well not have arisen. The lessons for drafters of security documents, especially those drafting cessions *in securitatem debiti*, are to avoid conflating or combining concepts that are legally and functionally distinct such as an out-and-out cession and a cession *in securitatem debiti* (whether it is based on the pledge theory or the outright cession theory), and to consistently reflect the parties' commercial intentions throughout the security document(s).

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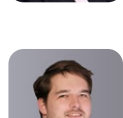
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